

**INTERCO 1988 ANNUAL REPORT**

## Contents

- 1 Highlights
- 2 Letter to Our Shareholders
- 6 Apparel Manufacturing Group
- 10 General Retail Merchandising Group
- 14 Footwear Manufacturing and Retailing Group
- 18 Furniture and Home Furnishings Group
- 22 Management's Discussion and Analysis of Results of Operations and Financial Condition
- 25 Consolidated Financial Section
- 41 Independent Accountants' Report
- 42 Five Year Consolidated Financial Review
- 43 Major Brand and Trade Names
- 44 Board of Directors
- 46 Corporate Officers and Operating Board
- 47 Principal Companies of INTERCO
- 48 Shareholder Information

■ **INTERCO Today** is a broadly based major manufacturer and retailer of consumer products and services represented by four operating groups.

■ **Apparel Manufacturing Group** consists of 11 apparel companies operating 45 manufacturing plants and 10 major distribution centers. The group designs, manufactures and distributes a full range of branded and private-label sportswear, casual apparel, outer garments and headwear for men and women. Distribution is national in scope to department stores, specialty shops and other retail units. Substantial distribution, under private and branded labels, is also made to large national retail and discount chains.

■ **General Retail Merchandising Group** operates 201 retail locations in 15 states. General retailing includes large do-it-yourself home-improvement centers, general merchandise discount stores, men's specialty apparel shops, and specialty department stores. Six regional distribution centers support these retail locations.

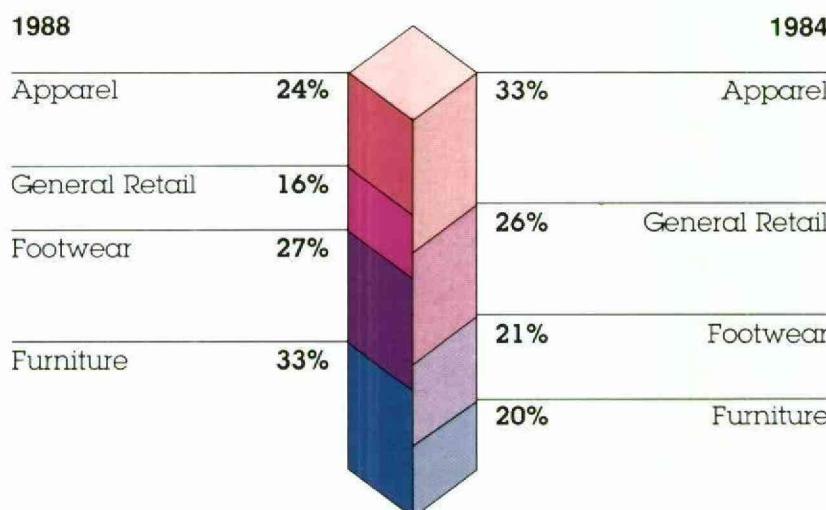
■ **Footwear Manufacturing and Retailing Group** styles, manufactures and distributes primarily men's footwear, and a broad range of athletic footwear, principally in the United States, Australia, Canada and Mexico. There are 14 manufacturing plants and five major distribution centers in operation. The group operates 778 retail shoe stores and leased shoe departments in 42 states in this country, as well as in Australia, Canada and Mexico. Footwear products are also distributed in more than 85 foreign countries.

■ **Furniture and Home Furnishings Group** manufactures and distributes quality furniture and home furnishings. There are 64 factories and 17 major distribution centers and consolidation warehouses located throughout the United States. The company also owns and operates 24 galleries.

## HIGHLIGHTS

Years Ended	February 29, 1988	February 28, 1987	Change
From operations:			
Net sales	<b>\$3,341,423,000</b>	\$2,946,902,000	13.4 %
Net earnings	<b>145,003,000</b>	125,774,000	15.3 %
As a percent of sales	<b>4.3%</b>	4.3%	
Per share of common stock:			
Net earnings	<b>\$3.50</b>	\$2.91	20.3 %
Dividends	<b>\$1.60</b>	\$1.57	1.9 %
Financial condition:			
Working capital	<b>\$ 985,956,000</b>	\$ 928,428,000	6.2 %
Current ratio	<b>3.6 to 1</b>	3.6 to 1	
Total assets	<b>1,985,586,000</b>	1,925,387,000	3.1 %
Shareholders' equity	<b>1,251,337,000</b>	1,326,215,000	(5.6)%
Book value per common share	<b>\$33.01</b>	\$31.47	4.9 %
Shares outstanding at year end:			
Common	<b>36,183,036</b>	40,173,254	
Preferred	<b>571,133</b>	617,946	
Number of shareholders	<b>12,500</b>	11,100	
Number of employees	<b>54,000</b>	53,000	

### Percent of Sales by Operating Group: 1988 and 1984



**Repositioning:**  
The graph on the left depicts the company's strategic repositioning program which commenced in fiscal 1984.

Fiscal 1984 sales are as originally reported.

## TO OUR SHAREHOLDERS

The repositioning program INTERCO initiated a few years ago resulted in significant strides last year toward the company's three main goals:

- Long-term sales and earnings growth;
- Increased return on corporate assets; and
- Improved return on shareholders' equity.

Fiscal 1988 net income increased 15.3%, to \$145.0 million from \$125.8 million the prior year and per share earnings rose to \$3.50 from \$2.91 a year ago. Sales were up 13.4%, to \$3.34 billion, from \$2.95 billion. Fiscal 1987 results were restated for the April 1987 merger with the Lane Company.

Lane and Converse, both relatively recent additions to the INTERCO family of companies, made significant contributions to last year's improved sales and profits, demonstrating the effectiveness of our repositioning program. In total, the Furniture and Home Furnishings and the Footwear Manufacturing and Retailing Groups registered outstanding results in fiscal 1988. Earnings were also favorably impacted by a lower effective tax rate, 42.8%, versus 47.1% in fiscal 1987, as a result of the Federal Tax Reform Act of 1986. A further decline in INTERCO's tax rate, to about 40%, is expected this year.

We continued to show steady progress in our most important goal – return on shareholders' equity – which rose to 11.7% from 9.7% last year. Our goal in this key area remains at the 14% to 15% range. The improvements came about despite \$6 million in costs, both pretax and aftertax, related to the Lane merger and a pretax charge of \$11.6 million associated with the restructuring of the women's sportswear segment of our Apparel Manufacturing Group. Stringent cost controls, an important discipline at INTERCO, also contributed to the better returns.

### ■ Strategic Direction

We will continue to follow three basic approaches in the achievement of our corporate goals:

- Improve profitability of existing operations and divest underperforming assets;
- Make acquisitions that have potential for better-than-average returns, as well as growth; and
- Employ financial strategies, primarily share repurchases and prudent use of borrowing capacity.

All three have been utilized in producing improved results since fiscal 1985 when INTERCO accelerated its efforts to divest underperforming assets and reposition the company in markets offering good growth opportunities.

This past year, we took several additional key steps to improve profitability:

- We restructured our women's apparel business. This action was in response to fundamental changes in the markets for women's sportswear;
- International Shoe Company was realigned with the Florsheim Shoe Company. This move will produce improved operating efficiencies and cost savings, as well as a more cohesive marketing effort;
- Big Yank and Cowden operations were similarly realigned, linking the best manufacturing and marketing aspects of both.

The merger with the Lane Company was a very important one since it positioned INTERCO not only to participate in the fast-growing recliner market, but also represented the addition of a well respected major furniture manufacturer with a broad range of quality products.

We remain alert to acquisition possibilities, particularly in the furniture and home furnishings sector. Our criteria have not changed and have served us well. In brief, we look for companies that: 1) have outstanding products, market leadership and brand loyalty

from consumers; 2) have a sound earnings record; 3) have strong management that will continue with the operation following acquisition; 4) have above-average growth potential, and 5) are complementary to our existing businesses.

INTERCO accelerated its share repurchase program following the market decline of October 19, 1987, finding our stock an especially good value. We completed our previous authorization of 2.6 million shares and the Board of Directors authorized an additional buyback of up to 5 million shares, of which 2.6 million shares remain to be purchased.

We are encouraged by our progress over the past few years. Pursuing a steady, well defined strategy, INTERCO has changed substantially the mix of its sales and earnings profile. In fiscal 1988 the Furniture and Footwear Groups combined accounted for 60% of corporate sales, with Apparel and General Retail representing 40%. Five years earlier, as originally reported, the distribution was reversed.

#### **■ Operating Group Performance**

##### **Furniture and Home Furnishings**

Operating profit rose to \$149.1 million from \$123.8 million the prior year, as Broyhill, Ethan Allen and Lane all contributed to the record results. Sales rose to \$1.11 billion from \$967.4 million. INTERCO is now clearly the largest furniture manufacturer in the world.

Broyhill continued to expand its gallery program, bringing its total to 268, an impressive accomplishment considering that the first gallery was opened in 1981. About 40 more are scheduled to open this year. Responding to its dealers' requests for more in-depth training, Broyhill dedicated a formal education center last year, as well as an adjacent model showcase gallery that permits testing of merchandising and decorating concepts.

Ethan Allen expanded the curriculum of its innovative education center named the Ethan Allen College to offer additional training classes to the entire dealer organization, as

well as its own personnel. In support of long-range growth plans, the construction of a major case goods plant for the production of fine 18th century mahogany furniture has been approved. In addition, the company made further inroads into marketing furniture coordinates and accessories.

Lane has started its own gallery program, which promises to enhance its already strong market presence. The Lane name is synonymous with quality and we are enthusiastic about the long range opportunities for the Action Division, the nation's second largest maker of recliners. Indicative of this potential, Lane constructed a third recliner plant this past year, which started production late in the third quarter.

We are more optimistic about the furniture and home furnishings industry than we have ever been. Favorable demographics translate into more family formations, keeping the long-term outlook bright, despite cyclical fluctuations in housing starts and interest rates.

##### **■ Footwear Manufacturing and Retailing**

Operating profit surged 76.9% to a record \$92.2 million from \$52.1 million the prior year, while sales rose 34.2% to \$890.4 million from \$663.5 million. The September 1986 acquisition of Converse, a quality performance oriented company, marked INTERCO's entry into the attractive, fast-growing athletic and leisure footwear field. Converse had a record year in sales and earnings in fiscal 1988, with gains spanning a wide array of products, including the CONS performance basketball shoes, the well known *Chuck Taylor Canvas All Star* brand, and the GSV tennis shoes. Converse is particularly encouraged about opportunities in the women's and children's markets. International sales also hold considerable promise.

Florsheim retained its market dominance in the men's traditional footwear field. Helping to solidify that leadership position are new, innovative products such as Comfortech, a

<p>broad line of technologically advanced comfort shoes for dress, dress casual and casual wear. Comfortech is being marketed aggressively. Another innovation, the <i>Express Shop</i>, an electronic retailing system in Florsheim and Florsheim dealer stores, was expanded geographically, moving from an initial 60 units in Illinois to some 350 stores in 10 states. The <i>Express Shop</i> features several advantages including: 1) offering the entire Florsheim range of styles and sizes; 2) increasing sales per square foot; and 3) optimizing in-store inventory.</p> <p><b>■ General Retail Merchandising</b></p> <p>Central Hardware retained its dominant market position and achieved improvement in sales and earnings, but a highly promotional pricing environment overall contributed to a 3.7% decline in the General Retail Merchandising Group's operating profit, to \$39.1 million from \$40.6 million the prior year. Sales rose moderately to \$532.3 million from \$498.3 million. Central Hardware continues to emphasize its long-standing commitment to customer service and is well positioned to increase its market share. They continue to expand and opened, in March 1988, two new stores in existing markets - Memphis, TN. and Festus, MO.</p> <p>Fine's Men's Shops also continued to grow with five new stores opened in fiscal 1988. Our efforts at Golde's, United Shirt and Sky City concentrated primarily on remodeling existing locations and revising merchandising strategies in order to maintain adequate returns in their highly promotional and competitive markets.</p> <p><b>■ Apparel Manufacturing</b></p> <p>Intense competitive pressures continued to impact adversely the apparel business, particularly the women's segment. Operating profits for the Apparel Group, after the \$11.6</p>	<p>million restructuring charge, totaled \$20.2 million, compared with \$47.3 million the prior year. Sales slipped slightly to \$813.2 million from \$817.7 million. Negative factors include direct sourcing by department stores and expanded emphasis on private label apparel. Our response was to restructure and realign certain of these operations which will improve future profitability of the Group. We will continue to monitor our apparel manufacturing operations closely.</p> <p>The men's apparel segment performed satisfactorily. Londontown retains a leading market position. Particularly well received by consumers was a fashion-oriented, upscale wool coat line under the <i>London Fog</i> label. The former Campus Sportswear Co. changed its name to Megastar Apparel, in recognition of the successful broadening of its product line from one brand - <i>Campus</i> - to several including <i>J J Cochran</i> and <i>Le Tigre</i>.</p> <p><b>■ Financial Position</b></p> <p>In November 1987, a shelf registration was filed with the Securities and Exchange Commission for up to \$200 million of debt securities. Subsequently \$150 million of five-year notes, \$25 million of four-year notes, and \$25 million of three-year notes were sold, at favorable interest rates. In addition, we called for redemption the outstanding \$75 million of 14 1/4% Notes at par, which will provide significant interest savings.</p> <p>Our balance sheet remains strong. The current ratio at year-end stood at 3.6 to 1, and the debt-to-capitalization ratio, which includes capitalized leases, is a conservative 19.3%, providing ample financial flexibility.</p> <p>We anticipate capital expenditures of about \$75 million this year, compared with \$66 million in fiscal 1988. Once again, much of that budget will be targeted toward cost reductions and productivity improvements. Funds generated from operations will cover these expenditures.</p>
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#### ■ **Dividend Action**

In view of our improved operating results this past year, favorable long-term outlook and strong financial position, the Board of Directors on March 14, 1988 increased the annual dividend rate 7.5%, to \$1.72 per share from \$1.60 per share, effective with the dividend payable April 15, 1988.

#### ■ **Consistent Philosophy**

INTERCO's operating philosophy has been consistent. We concentrate on consumer products and services, in the popular to better price range, which enjoy market leadership. Our company is marketing-oriented and consumer-driven. It is the consumer who is ultimately the end user of our products and services. The consumer remains our main focus.

Our approach is to allow the operating companies a great deal of autonomy, permitting managers to utilize their entrepreneurial skills, which helped build these businesses. INTERCO Corporate provides the direction, guidance and financial disciplines, holding monthly operating board meetings at corporate headquarters and frequently visiting each operating unit.

#### ■ **Changes on the Board of Directors**

Three new members joined our Board of Directors during fiscal 1988. Coinciding with the April 1987 acquisition of The Lane Company, R. Stuart Moore, president of Lane, was elected to the board.

At the annual meeting in June, Richard B. Loynd, chairman of Converse, was elected a director by shareholders. In September, William E. Cornelius, chairman and chief executive officer of Union Electric Co., was elected a director.

These new directors will bring additional experience and capability to an outstanding board that has served the interests of our shareholders well.

Nathan S. Ancell, chairman of the board of Ethan Allen and truly a leader in the furniture industry, was named director emeritus, effec-

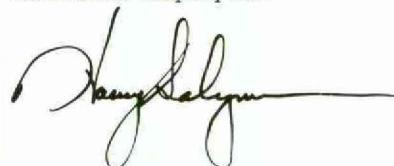
tive June 27, 1988. INTERCO has benefited greatly from his counsel and experience and we look forward to his continuing guidance.

#### ■ **Outlook**

As we enter fiscal 1989, the economic signals are mixed and currently consumer spending in most sectors of the economy is soft. Nevertheless, we are confident that we can extend the earnings progress made during the last three years into the new year.

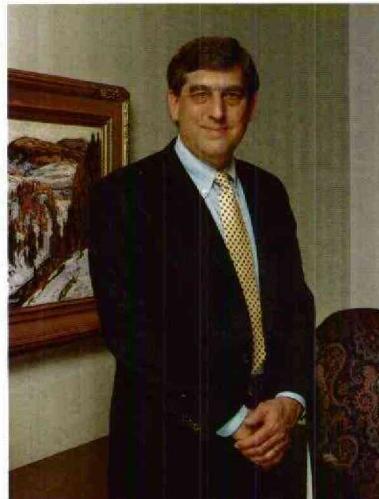
Although the company has made significant strides in the past years, we are far from complacent. Further improvements must be achieved, and we are committed to maximizing shareholder value.

On behalf of INTERCO's Board of Directors and management, we would like to express our appreciation to you for your continued support and to our loyal customers and dedicated employees.



Harvey Saligman  
Chairman of the Board and  
Chief Executive Officer

April 11, 1988



## APPAREL MANUFACTURING GROUP

During the year the Apparel Manufacturing Group, particularly the women's sportswear segment, continued to operate in a difficult market environment.

We continue to respond aggressively to these highly competitive conditions in an effort to improve the profitability of this group. The company's actions have centered on realigning and restructuring certain operations, changing product sourcing, where appropriate, and installing automated, more efficient manufacturing equipment. Definite progress has been achieved.

**Londontown's expertise and attention to detail are incorporated in a broad array of rainwear and outerwear products reflecting traditional as well as more fashion oriented styling.**





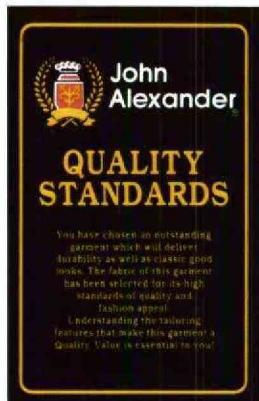
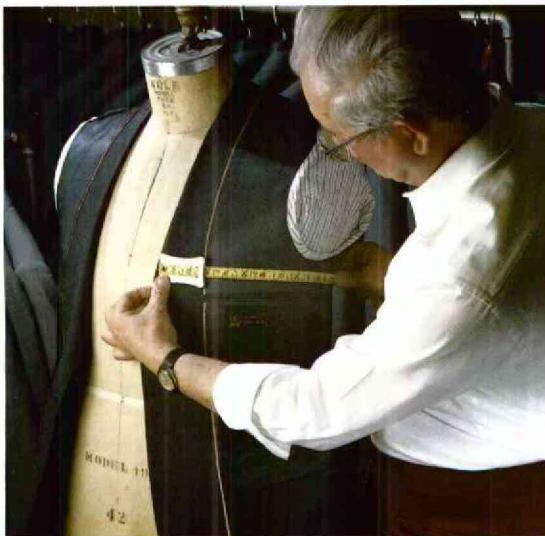
MEGASTAR



J.J.  
COCHRAN



BILTWELL



**Megastar, a major manufacturer of young men's sportswear, is recognized for its design and merchandising skills.**

**Biltwell's adherence to high quality standards has been an important factor in the successful expansion of its customer base.**

## APPAREL MANUFACTURING GROUP

**Below:**  
**Skirts for the career woman from Devon's new *Olivia* line**



**Opposite:**  
**Jacket and skirt from the coordinated sportswear collection of Abe Schrader's Separates Division**

The most significant remedial action taken during the year was the restructuring of our women's sportswear operations at College-Town and Queen Casuals. Although the move resulted in an \$11.6 million pretax charge to earnings, this

step will have a positive effect on future profitability.

Not all women's apparel sectors were soft last year.

Stuffed Shirt had an excellent year.

They were in step with fashion styles, and because it is predominately a

domestic manufacturer with two major U.S. plants, Stuffed Shirt was able to achieve quick response time to retailers' needs. Sophisticated, computerized laundering equipment has helped keep them price competitive.

Abe Schrader is targeting selected markets. G. B. Scott is an updated career line of dresses and ensembles aimed at the medium to better price range. Schrader Sport, particularly the shirt dress

line, continues to be well received by consumers.

Devon Apparel recently introduced a line of moderately-priced separates under the *Olivia* label which will be produced at a new Dominican Republic manufacturing facility.

The realignment of Cowden under Big Yank's management is already producing benefits. Although both companies remain free-standing units, acting together they will generate operating efficiencies. Each retains its own marketing identity. Cowden continues to emphasize basic jeans and the company recently signed a long-term manufacturing contract to produce American-made jeans and jackets for a major distributor of young men's denim products.

Big Yank is more fashion oriented and has launched a branded jeans program for boys and girls under the Sergio Valente label. Although primarily a domestic manufacturer, Big Yank does utilize offshore manufacturing sources, where beneficial. Big Yank has made substantial capital investments in automated equipment to enhance



productivity and reduce costs at its U.S. plants.

Londontown enjoyed particularly strong wool coat sales this past year. Its men's business more than doubled the last two years and the company introduced a new women's wool coat line that filled a marketing void in the \$200-

\$400 price range.

With a well defined marketing plan, Londontown produces rainwear and outerwear for three distinct lifestyles:

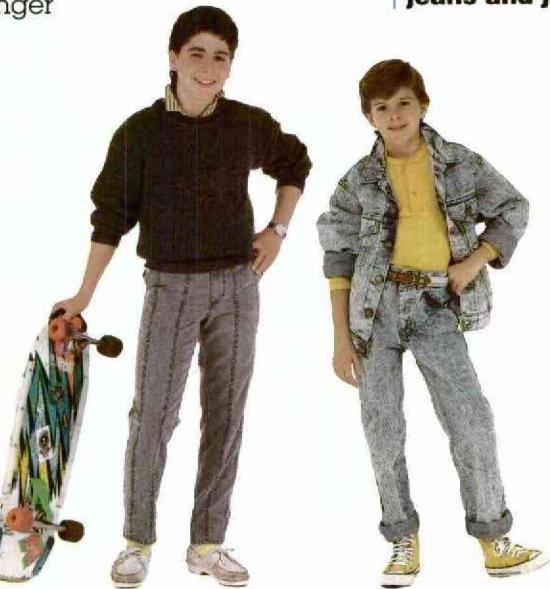
- 1) London Fog for the traditional, more conservative consumer;
- 2) *Tempo Europa*, for the upscale contemporary consumer; and 3) its newest label, *Fog*, for the high-fashion conscious consumer. Londontown makes widespread use of focus groups and other market research techniques to ensure that products fulfill the quality, style and value expectations of the consumer.

Megastar Apparel, formerly Campus Sportswear, continues to expand its products. It is introducing a complete line of woven dress shirts under the

J J Cochran label and a new juvenile apparel line under the *lil' Hunk* label. Megastar's joint venture Costa Rican plant, acquired last year, has performed well in supplying products at competitive cost levels while meeting rigid quality standards.

Biltwell's tailored men's business remains strong; consumers have recognized the combination of style and value, particularly in the *John Alexander* label. Fiscal 1989 will mark the first full year of productivity benefits from a centralized automated cutting system at the Farmington, MO., plant. Biltwell is also exploring additional sourcing possibilities to support future growth.

International Hat is currently emphasizing new fabrications and unique shapes directed toward casual wear and the younger consumer.



**Above:**  
**International Hat's casual headwear styles for men and women**

**Opposite:**  
**Stuffed Shirt's jeanswear related separates are garment-dyed for quick market response**

**Below:**  
**Big Yank's boys fashion look under the Sergio Valente label and Cowden's super white washed authentic western style jeans and jacket**

## GENERAL RETAIL MERCHANDISING GROUP

The General Retail Merchandising Group registered a slight decline in operating profit in fiscal 1988, primarily due to a more intense promotional atmosphere. Even so, we were pleased with the performance of Central Hardware and Fine's Men's Shops, as both posted improved sales and earnings.

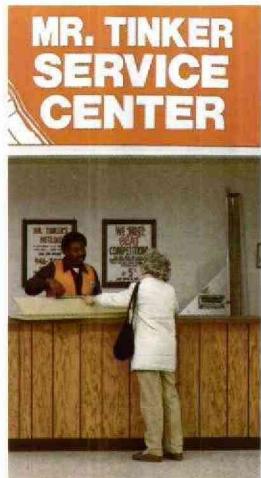
**In order to provide the optimum store layout to achieve customer convenience and ease of shopping, Central Hardware utilizes state-of-the-art computer technology in the design of new home improvement centers.**

Central's results were especially gratifying since the company was confronted with new, major competitors in several of its markets. However, they maintained their leading position in all their Midwest markets. The do-it-yourself home improvement chain continues to emphasize outstanding customer service, an integral part of its long-range strategy.



# CENTRAL HARDWARE®





**Key to the success of Central Hardware is its emphasis on customer service together with a broad selection of products.**



## GENERAL RETAIL MERCHANTISING GROUP

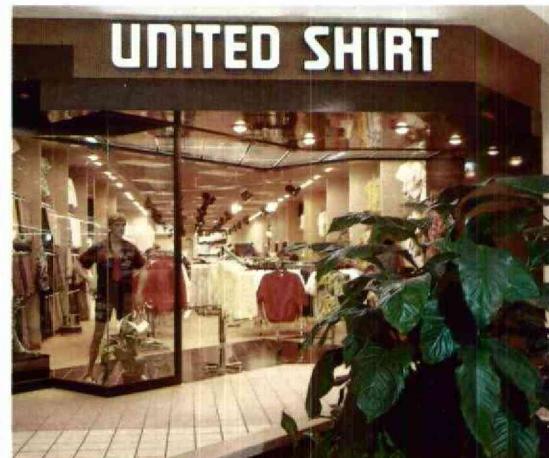
Steps taken by Central Hardware include:

- Customer service representatives at the front of the store to provide quick, helpful responses to consumer inquiries;
- Emphasis on Mr. Tinker centers, which offer a wide range of services including cutting lumber and other materials to customer specifications, assisting in project planning, and providing expert advice on home repairs; and
- A congenial return policy, to maximize customer convenience.

They continue to expand, having added two stores in March 1988 to their base of 35. On the drawing board for spring of 1989 is a store in Cape Girardeau, MO., southeast of St. Louis.

Central's management remains alert to further expansion opportunities.

Fine's Men's Shops opened five stores in fiscal 1988, raising its total number of units to 57. Further expansion of approximately 10% is planned for this year.



**Opposite:**  
**United Shirt**  
**operates men's**  
**specialty stores**  
**in the upper**  
**Midwest area**

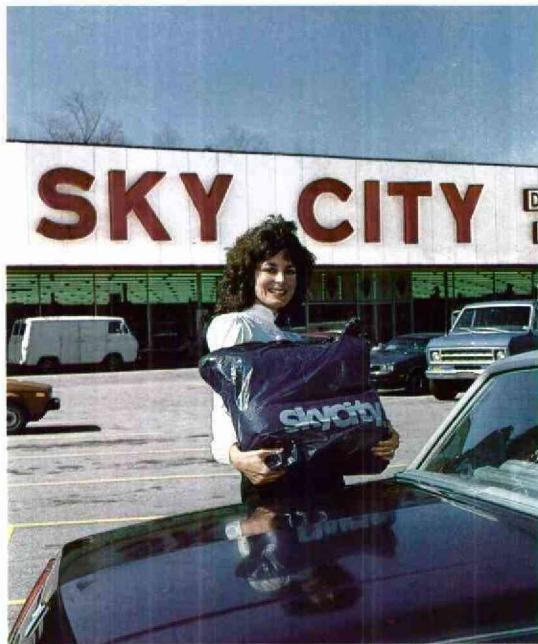
**Opposite:**  
**Fine's Men's Shops**  
**operates a chain of**  
**men's specialty**  
**stores in the Mid-**  
**Atlantic states**



Fine's continues to benefit from advanced point-of-sale terminals, which provide improved customer service and inventory management.

United Shirt's strategy during fiscal 1989 will include concentrating on improved merchandise programs with emphasis on fashion items. The company continues to seek new locations.

Sky City is experiencing a highly competitive environment, as price promotions are intensifying among general merchandise discount store retailers in the Southeast. The chain continues to upgrade its high-volume stores, while relocating or closing marginal or unprofitable units.



**Opposite:**  
**Golde's operates specialty department stores in Missouri and Illinois**

Golde's Department Stores has implemented a change in its merchandise mix. The St. Louis-based chain is emphasizing women's career apparel, reflecting the ongoing trend toward more women in the workforce. Golde's is also stressing service, with employees receiving more concentrated training in this area.

**Opposite:**  
**Sky City operates a chain of large convenience stores in the Southeast**

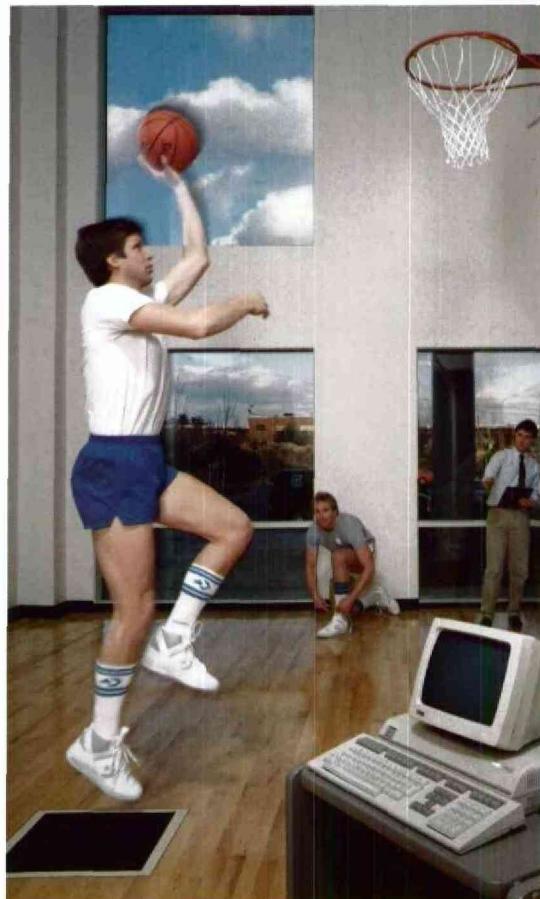
## FOOTWEAR MANUFACTURING AND RETAILING GROUP

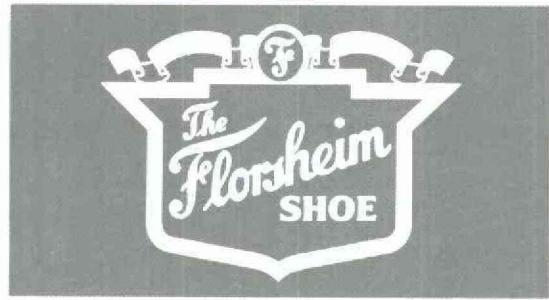
Paced by Converse Inc. and The Florsheim Shoe Co., footwear operations achieved a record performance.

Converse and Florsheim fit perfectly into INTERCO's overall strategic thrust: both command a leading position in their respective markets – athletic shoes and men's traditional footwear. Both have a reputation for designing products of outstanding quality and style, with the comfort of the consumer uppermost in mind.

Converse, which has over a 75-year tradition, continues to broaden its product lines, which include *Cons* and *Fast Break* basketball, Chuck Taylor All Star canvas,

**Recognizing that its continued success is dependent on technical competence and innovation, Converse conducts extensive research and development at its North Reading, Massachusetts biomechanics laboratory.**





## Everybody talks comfort. Florsheim guarantees it.

Purchase these Comfortech shoes from a participating Florsheim dealer between now and March 31, 1988. Wear them for 30 days. If not satisfied, bring them back to where you purchased them (with your sales receipt) and receive a full refund.



In the past few months, Florsheim Comfortech has started a revolution. Never before has a dress shoe looked this good and been this comfortable. The secret is in the advanced technology that enables us to custom-contour the shoe to the natural curve of your foot. It fits as though it were designed just for you. This light-weight dress shoe is so

customized from top to bottom, the support is like nothing you've experienced before. But rather than just read about Comfortech, we suggest a visit to your Florsheim dealer instead. That way you can experience the pleasure for yourself. And with our 30-day "no risk" offer, there's no better time than now.

**COMFORTECH®**  
BY FLORSHEIM  
Trademark of Florsheim Incorporated



**Carefully selected materials and superior craftsmanship are the cornerstone of Florsheim's reputation for quality and value.**

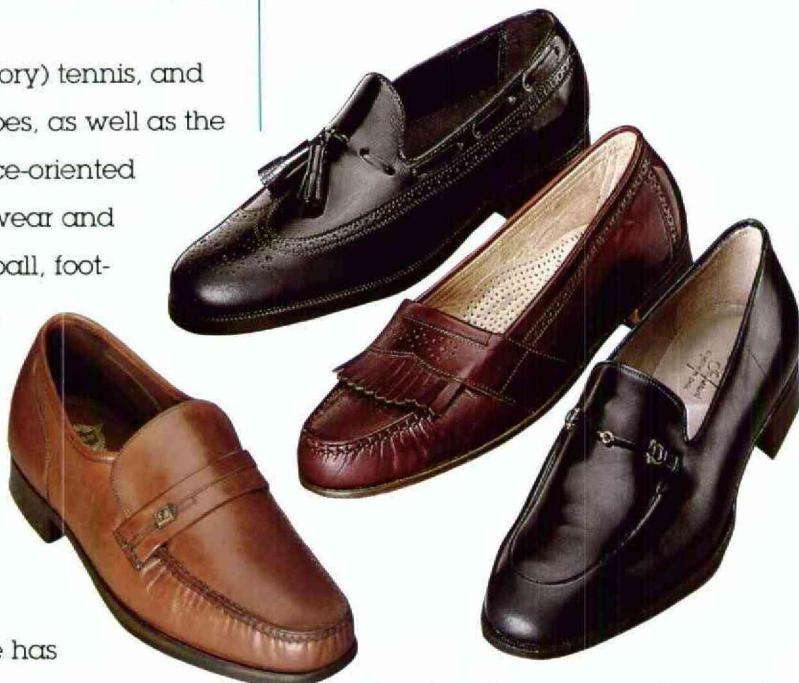
## FOOTWEAR MANUFACTURING AND RETAILING GROUP

**Opposite:**  
**Selected styles of**  
**Florsheim's lead-**  
**ing dress and**  
**casual footwear**  
**for men**

GSV (Grand Slam Victory) tennis, and Conveyor walking shoes, as well as the Hamptons performance-oriented dress and casual footwear and cleated baseball, softball, football and soccer shoes.

During the year they introduced in several key markets the Evolo brand, an upscale fashion athletic shoe. Initial consumer acceptance has been encouraging.

In February 1988, Converse introduced a technical breakthrough - the Energy Wave, a revolutionary material, providing a superior energy return capability, which is adaptable to a broad range of athletic footwear. This development represents a continuation of their



leadership in serving the needs of athletes throughout the world.

The accelerating export market, assisted by the declining U.S. dollar, is supplying additional momentum to international growth. Sales have been particularly brisk in Canada and Western Europe.

Florsheim, which was founded in 1892, will market aggressively its broad, attractive ComforTech line this year, as well as the popular Riva and Idlers styles. The Florsheim women's line was successfully broadened beyond the career woman market to include casual footwear.

The realignment of International Shoe Co. with Florsheim will be completed during the new year and should result in a more coordinated approach in the merchandising, manufacturing and

**Below:**  
**Converse's athletic**  
**footwear appeals**  
**to a wide range of**  
**consumers**





Senack Shoes has been successful operating leased shoe departments. They have been in an expansion mode and expect to continue growing their operations.

**Opposite:**  
**Styles representa-**  
**tive of the expand-**  
**ing Florsheim**  
**women's line**

marketing activities of these two operating companies. Emphasis will be placed on the continued expansion of branded women's products including the *Avenues*, *Accents* and *Marshmallows* lines. Efforts will also be concentrated on the growth of the *Hy-Test* Safety Footwear Division.

In its retail operations, Florsheim continued its program of closing or relocating marginal locations and is focusing on its traditional expertise in operating full-line shoe shops. During fiscal 1989, Florsheim plans to open additional company-owned stores in areas convenient to its customers, while also continuing its aggressive updating and remodeling program.

Notwithstanding near-term concerns over consumer confidence levels, INTERCO's two major footwear operations have inherent strengths:

- Florsheim is the nation's premier manufacturer of men's dress and dress/casual footwear. Technological advances are being incorporated in expanded product offerings without diminishing Florsheim's dedication to quality and craftsmanship.
- Converse features attractive, broad product lines in the above-average growth athletic shoe sector, which has been increasing approximately 15% annually the past five years.

**Below:**  
***Hy-Test* is a lead-**  
**ing brand in the**  
**safety footwear**  
**market**

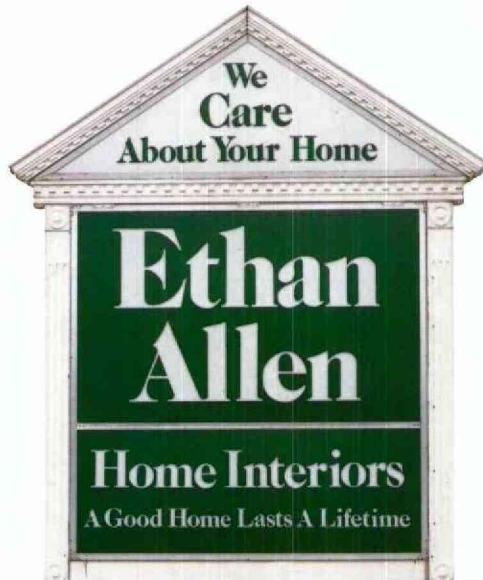
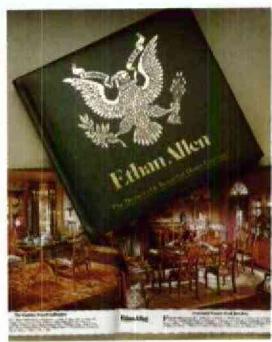


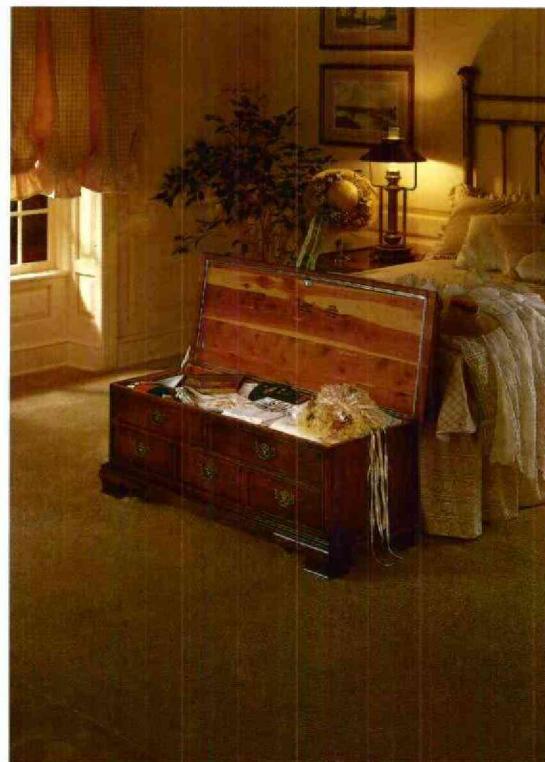
## FURNITURE AND HOME FURNISHINGS GROUP

The Furniture and Home Furnishings Group had a record year in fiscal 1988. Broyhill, Ethan Allen and Lane each played a significant role in the earnings improvement.

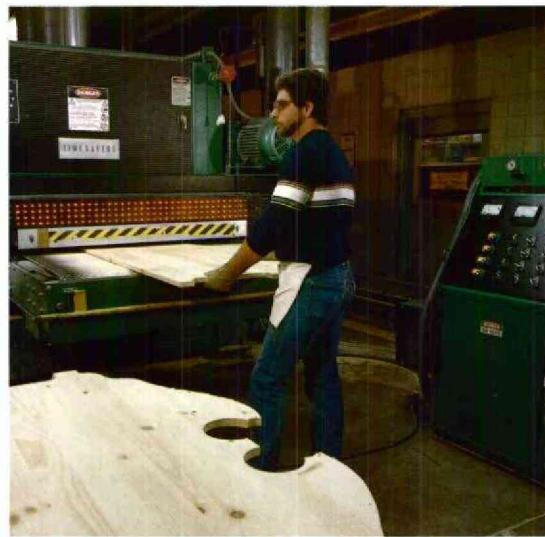
Ethan Allen, which markets exclusively through some 300 independent Ethan Allen Gallery operators, continues to broaden its product line. The company shortly will commence construction of a major case goods plant for the production of 18th century mahogany veneer dining room and bedroom furniture. The new line is expected to augment the popular Georgian Court collection.

**In support of its commitment to help families in creating a beautiful home, Ethan Allen conducts an extensive training program for dealer personnel through the Ethan Allen College.**





**The Lane Company  
has been crafting  
fine furniture for  
over 75 years.**



**Broyhill is an  
industry leader in  
the use of ad-  
vanced manufac-  
turing equipment  
and provides a  
complete line of  
quality furniture at  
popular prices.**



## FURNITURE AND HOME FURNISHINGS GROUP

**Opposite:**  
**Old World Treasures – antique reproductions from Ethan Allen**

The Ethan Allen College, a pioneering concept in the industry, expanded its curriculum. Total attendance approximated 5,000 students during the year.

Fitting into Ethan Allen's concept of creating an entire home environment, furniture coordinates such as lighting, floor covering, wall decor, draperies and textiles, increased their market penetration last year. In addition, the company is offering a new accessory – reproductions of famous paintings at popular prices.



**Above:**  
**Broyhill's Hanayama Bedroom collection featuring Chinoiserie decorations**

Broyhill increased its number of showcase galleries by 38, while an additional 109 were updated or expanded by participating dealers. Major expansion was also achieved in the Independent Dealer

Program, started in late 1986 to help smaller retailers increase market share through improved advertising and support programs. From an initial test market of 72 dealers, the total was increased sharply to approximately 600.

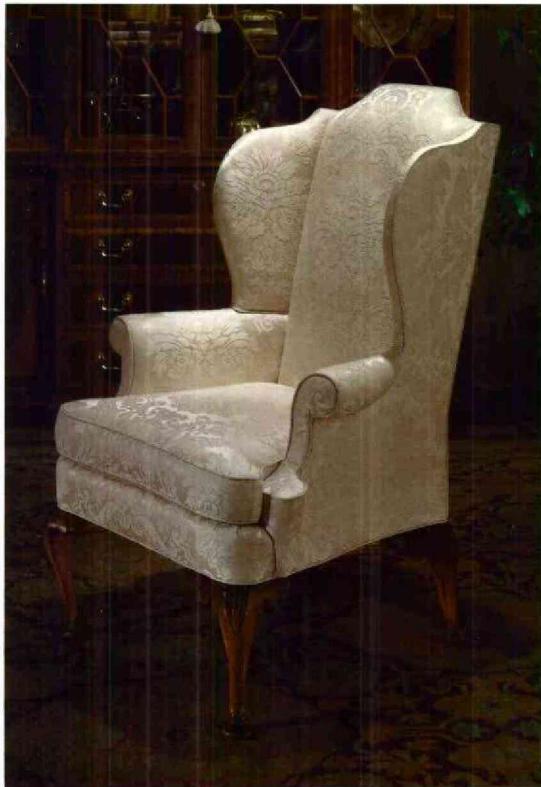
Broyhill's education center in Lenoir, N.C., dedicated in November 1987, offers specially designed curriculum such as store management and sales training seminars for its dealers. An 8,200 square-foot model showcase gallery, adjacent to the education center, not only allows decorating ideas to be tested, but is also utilized for role-playing sales training classes.

New product offerings last year included:

- the Country Treasures Collection, a broad line of furniture in cherry which

includes bedroom and dining room furniture, occasional tables, wall units and upholstery;

- the Hanayama Collection, designed to appeal to recent consumer demand for furniture with Chinoiserie (oriental scenes). A new process delivers Chinoiserie at traditional Broyhill popular-price points, rather than more expensive prices previously because of improved manufacturing techniques.



Lane, through a joint marketing venture between its Hickory Tavern, HTB and Lane divisions, has launched a gallery program. The breadth of the Lane furniture lines and quality and styling of its offerings provide the foundation for a uniquely powerful



gallery program.

Recently, Hickory Chair introduced an exciting new collection developed in conjunction with one of America's leading interior designers, Mark Hampton.

The Lane Company's America Collection, now in its seventh year, continues to expand and meet with good consumer acceptance. The collection was inspired by pieces from the Museum of American Folk Art.

Reflecting Lane's growth potential was the completion last year of a 324,000 square-foot recliner plant for the Action Division. In addition, a new headquarters building is under construction.

While the economic outlook, notably for housing starts, remains uncertain, we believe our furniture operations are well positioned to outperform the industry. We remain confident in their long-term growth prospects.

**Opposite:**  
**A best selling reclining chair manufactured by The Action Division of Lane**

**Opposite:**  
**An 18th Century reproduction from the historic James River Collection of Lane's Hickory Chair Division**

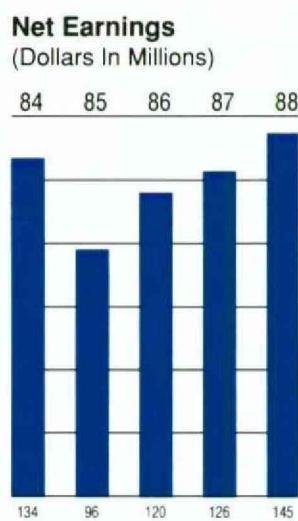
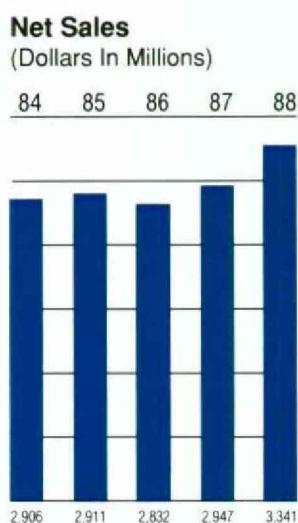
## **Management's Discussion and Analysis of Results of Operations and Financial Condition**

### **Results of Operations**

This discussion supplements the detailed information presented in the consolidated financial statements and footnotes which begin on page 26.

Results for fiscal 1987 and 1986 are restated for the April 1987 merger with The Lane Company, Incorporated which was accounted for on a pooling of interests basis.

#### **■ Net Sales**



#### **■ Net Sales**

Net sales for fiscal 1988 were \$3.34 billion, an increase of 13.4% from \$2.95 billion achieved last year. Net sales for fiscal 1987 increased 4.0% from \$2.83 billion in fiscal 1986. The sales increase in fiscal 1988 was primarily due to results in the Footwear Manufacturing and Retailing Group and the Furniture and Home Furnishings Group. The Footwear Group results benefited from a significant increase at Converse, together with smaller gains at the other footwear companies. Within the Furniture Group, each company experienced solid gains over the prior year. General Retail Merchandising Group sales also increased, aided by additional retail locations in the company's do-it-yourself home improvement sector. Sales for the Apparel Group declined in both years primarily due to results in the women's apparel segment. Sales for the men's apparel segment increased moderately in fiscal 1988. The net sales increase in fiscal 1987 was principally attributable to the acquisition of Converse in September 1986.

#### **■ Other Income, Net**

Other income decreased by 9.1% in fiscal 1988 to \$29.2 million. The decrease was due mainly to a reduction in interest income. For fiscal 1987, other income decreased by 11.0% as a result of lower interest income and also the inclusion of non-recurring gains on sales of marketable securities in fiscal 1986.

#### **■ Gross Margins**

Gross margins for fiscal 1988 were \$1,056.8 million, or 31.6% of net sales, as compared to \$946.5 million, or 32.1% and \$900.1 million, or 31.8% for fiscal 1987 and 1986, respectively. For fiscal 1988, the Footwear Manufacturing and Retailing Group showed improved gross margins. The Furniture and Home Furnishings Group's margins were level as a percent of sales while up substantially in absolute amount. The Apparel Manufacturing and the General Retail Merchandising Groups had declines. The Apparel Group results were affected by the restructuring charge, as discussed in footnote 14, as well as the continued highly promotional conditions in its market place. In the General Retail sector, the company's ongoing cost reduction and productivity improvement programs served to partially offset the margin pressure resulting from promotional price pressures and the continued addition of retail locations by competition. The improvement in fiscal 1987 consolidated gross margins was principally attributable to higher gross margins in the Furniture Group, as well as the General Retail Group.

### ■ Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$799.0 million, \$712.9 million and \$681.9 million for fiscal 1988, 1987 and 1986, respectively. As a percent of sales, selling, general and administrative expenses were 23.9% for fiscal 1988, as compared to 24.2% for fiscal 1987 and 24.1% for fiscal 1986. Expenses have been held fairly constant as a percent of sales due to the company's continued focus on expense control efforts in all areas of operations.

### ■ Interest Expense

Interest expense in fiscal 1988 amounted to \$33.5 million compared to \$28.1 million in fiscal 1987 and \$25.5 million in fiscal 1986. The increase in fiscal 1988 was due mainly to higher levels of short-term borrowings associated with the company's share repurchase program and also as a result of debt initially incurred in the prior year for the Converse and other cash acquisitions. The increase in fiscal 1987 was due to higher levels of short-term borrowings, primarily related to the Converse acquisition, partially offset by reductions in interest on long-term debt and capital lease obligations.

### ■ Income Taxes

The effective tax rate for fiscal 1988 was 42.8% compared to 47.1% and 47.6% in fiscal 1987 and 1986, respectively. The decrease in the effective tax rate during the past two years was due to the reduction in corporate income tax rates in the 1986 Tax Reform Act and the favorable tax effect of certain manufacturing operations in Puerto Rico.

Late last year the Financial Accounting Standards Board issued Statement No. 96, Accounting For Income Taxes. Adoption of FAS 96 will result in a cumulative tax adjustment that may be reported in income in the year of implementation. The company is currently studying the provisions of FAS 96 and has not yet decided when it will be adopted.

### ■ Earnings Per Share

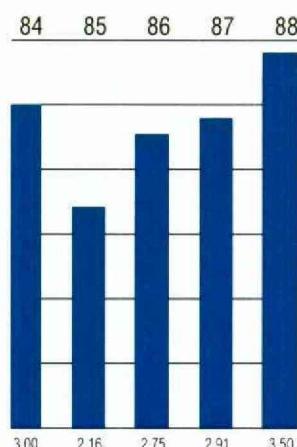
Earnings per share for fiscal 1988 were \$3.50, an increase of 20.3% from \$2.91 in fiscal 1987 and \$2.75 in fiscal 1986. The increase for fiscal 1988 reflects the strong earnings improvement for the Footwear Group and the Furniture Group, as well as the lower effective income tax rate and fewer average common shares outstanding. The earnings improvement in fiscal 1987 was attributable to better results in all operating groups, except for the Apparel Manufacturing Group.

## Financial Condition

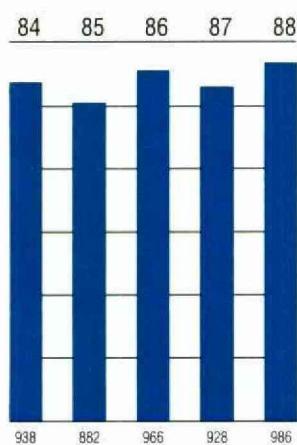
The company's financial condition remains strong.

■ Working capital, the excess of current assets over current liabilities, was \$986.0 million at the end of fiscal 1988. The current ratio was 3.6 to 1 at February 29, 1988, retaining the same favorable liquidity position as at the end of the prior fiscal year.

### Earnings per share



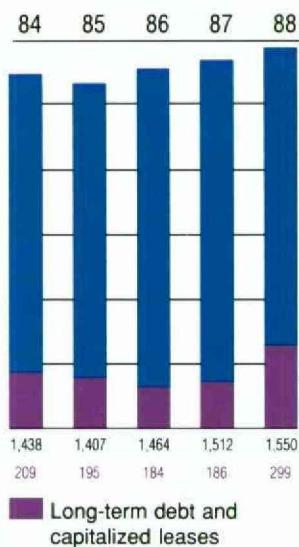
### Working Capital (Dollars In Millions)



## **Management's Discussion and Analysis of Results of Operations and Financial Condition (Cont'd)**

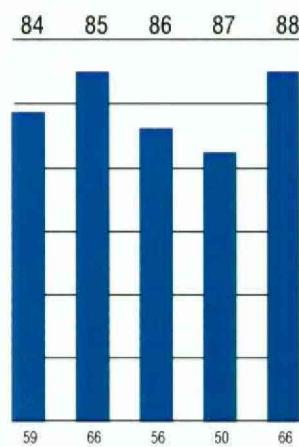
### **Total Capitalization**

(Dollars in millions)



### **Capital Expenditures**

(Dollars In Millions)



■ Cash and short-term investments totaled \$31.9 million, a decrease of \$48.5 million from a year ago. At year end, short-term borrowings amounted to \$70.5 million as compared to \$68.8 million last year. The decrease in cash and increase in borrowings of \$50.2 million was primarily related to the company's share repurchase programs.

■ Long-term debt and obligations under capital leases totaled \$299.1 million at February 29, 1988, an increase of \$113.6 million during the year. In fiscal 1988 the company issued \$200 million in new intermediate term debt securities, with maturities ranging from three to five years, with a weighted average interest rate of 8.75%. Also, on February 15, 1988, the company redeemed, at par, the \$75 million of 14 1/4% Notes outstanding. As a result, the company's debt-to-capitalization ratio was 19.3% at year end as compared to 12.3% twelve months earlier.

#### **Financing Arrangements**

To meet short-term working capital and other financial requirements, the company has revolving credit agreements enabling it to borrow up to \$150 million in domestic and Euro-Dollar loans through 1995 and \$50 million in Euro-Dollar loans through 1992. These credit facilities are mainly intended to support commercial paper borrowings. The company also maintains other bank lines of credit as credit availability and additional support for the sale of commercial paper.

#### **Capital Expenditures**

Capital expenditures for company-owned and capitalized leased property aggregated \$297.2 million during the last five years, of which \$65.9 million occurred in fiscal 1988. Cash flow from operations provides the principal source of funds for capital expenditures. For fiscal 1989, capital expenditures are forecast to be approximately \$75 million, with depreciation estimated at about \$62 million.

#### **Dividends**

Cash dividends of \$64.2 million were paid during the fiscal year, with \$59.6 million to holders of common stock and the remainder to holders of preferred stock. The quarterly dividend rate on common stock was increased to \$0.43 per share from \$0.40, or an annual rate of \$1.72 per common share, effective with the dividend payable on April 15, 1988. The impact of this dividend increase on aggregate dividend payments in fiscal 1989 will be partially offset by the estimated fewer common shares outstanding than during fiscal 1988.

#### **Share Repurchase Program**

During fiscal 1988, the company purchased more than four million shares of its outstanding stock for \$152.3 million in conjunction with its share repurchase programs.

**INTERCO**  
**Consolidated**  
**Financial Statements**

**Contents**

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- 26** Consolidated Balance Sheet
- 28** Consolidated Statement of Earnings
- 29** Consolidated Statement of Changes  
in Financial Position
- 30** Consolidated Statement of  
Shareholders' Equity
- 31** Notes to Consolidated Financial  
Statements
- 41** Independent Accountants' Report

**Consolidated  
Balance Sheet**  
(Dollars in thousands)

<b>Assets</b>	<b>February 29, 1988</b>	February 28, 1987	February 28, 1986
Current assets:			
Cash	\$ 20,849	\$ 16,631	\$ 16,586
Marketable securities	11,033	63,747	127,341
Receivables, less allowances of \$21,222 (\$20,881 in 1987 and \$20,021 in 1986)	486,657	446,755	402,225
Inventories	805,095	733,907	647,116
Prepaid expenses and other current assets	35,665	25,614	22,547
Total current assets	<u>1,359,299</u>	1,286,654	1,215,815
Property, plant and equipment:			
Land	32,525	32,266	26,770
Buildings and improvements	471,787	465,811	437,812
Machinery and equipment	380,402	364,499	320,256
Less accumulated depreciation	884,714	862,576	784,838
Net property, plant and equipment	<u>405,215</u>	377,226	343,018
Other assets	<u>146,788</u>	<u>153,383</u>	<u>99,258</u>
	<u>\$1,985,586</u>	<u>\$1,925,387</u>	<u>\$1,756,893</u>

See accompanying notes to consolidated financial statements.

<b>Liabilities and Shareholders' Equity</b>	<b>February 29, 1988</b>	<b>February 28, 1987</b>	<b>February 28, 1986</b>
Current liabilities:			
Notes payable	\$ 70,517	\$ 68,840	\$ —
Current maturities of long-term debt and capital lease obligations	8,172	11,915	9,647
Accounts payable	176,576	160,517	149,792
Accrued employee compensation	50,739	43,779	43,209
Other accrued expenses	62,937	55,848	34,240
Income taxes	4,402	17,327	12,699
Total current liabilities	<u>373,343</u>	<u>358,226</u>	<u>249,587</u>
Long-term debt, less current maturities	257,327	135,019	127,409
Obligations under capital leases, less current maturities	41,813	50,546	56,495
Other long-term liabilities	61,766	55,381	43,249
Shareholders' equity:			
Preferred stock, no par value, authorized 10,000,000 shares—issued 571,133 shares in 1988, 617,946 shares in 1987 and 660,273 shares in 1986	57,113	61,795	66,027
Common stock, \$3.75 stated value, authorized 125,000,000 shares—issued 41,356,847 shares in 1988, 43,638,211 shares in 1987 and 43,670,559 shares in 1986	155,088	163,643	163,765
Capital surplus	44,539	98,246	104,205
Retained earnings	<u>1,179,964</u>	<u>1,099,006</u>	<u>1,027,895</u>
	<u>1,436,704</u>	<u>1,422,690</u>	<u>1,361,892</u>
Less 5,173,811 (3,464,957 and 3,122,928 in 1987 and 1986, respectively) shares of common stock in treasury at cost	185,367	96,475	81,739
Total shareholders' equity	<u>1,251,337</u>	<u>1,326,215</u>	<u>1,280,153</u>
	<u>\$1,985,586</u>	<u>\$1,925,387</u>	<u>\$1,756,893</u>

## **Consolidated Statement of Earnings**

(Dollars in thousands except per share data)

<b>Years Ended</b>	<b>February 29, 1988</b>	<b>February 28, 1987</b>	<b>February 28, 1986</b>
Income:			
Net sales	\$3,341,423	\$2,946,902	\$2,832,384
Other income, net	<u>29,237</u>	32,175	36,140
	<u><u>3,370,660</u></u>	<u><u>2,979,077</u></u>	<u><u>2,868,524</u></u>
Costs and expenses:			
Cost of sales	2,284,640	2,000,423	1,932,258
Selling, general and administrative expenses	<u>799,025</u>	712,861	681,886
Interest expense	<u>33,535</u>	28,082	25,523
	<u><u>3,117,200</u></u>	<u><u>2,741,366</u></u>	<u><u>2,639,667</u></u>
Earnings before income taxes	253,460	237,711	228,857
Income taxes	<u>108,457</u>	111,937	109,008
Net earnings	<u><u>\$ 145,003</u></u>	<u><u>\$ 125,774</u></u>	<u><u>\$ 119,849</u></u>
Earnings per share	<u><u>\$ 3.50</u></u>	<u><u>\$ 2.91</u></u>	<u><u>\$ 2.75</u></u>

See accompanying notes to consolidated financial statements.

## Consolidated Statement of Changes in Financial Position

(Dollars in thousands)

Years Ended	February 29, 1988	February 28, 1987	February 28, 1986
Working capital provided by:			
Net earnings	<b>\$145,003</b>	\$125,774	\$119,849
Items not affecting working capital:			
Depreciation	<b>62,772</b>	54,885	51,346
Other, net	<b>13,957</b>	10,357	15,344
Operations	<b>221,732</b>	191,016	186,539
Disposal of property, plant and equipment	<b>8,102</b>	5,433	6,820
Issuance of preferred stock	<b>—</b>	—	249
Issuance of common stock	<b>4,606</b>	11,540	15,005
Additions to long-term debt	<b>200,000</b>	253	158
Additions to capital lease obligations	<b>5,673</b>	735	1,409
To conform pooled company fiscal year	<b>—</b>	2,363	—
Other, net	<b>54</b>	993	8,587
	<b>440,167</b>	212,333	218,767
Working capital used for:			
Cash dividends	<b>64,219</b>	58,245	56,485
Additions to property, plant and equipment:			
Company owned property	<b>60,207</b>	49,378	54,404
Capitalized leased property	<b>5,673</b>	735	1,409
Reduction of long-term debt	<b>77,692</b>	36,157	6,537
Reduction of capital lease obligations	<b>14,406</b>	6,684	6,317
Purchase of common treasury shares	<b>152,255</b>	31,045	2,250
Retirement of preferred stock	<b>6,266</b>	2,112	185
Conversion of preferred stock	<b>1,921</b>	3,432	7,450
	<b>382,639</b>	187,788	135,037
Acquisitions (less working capital of \$110,731 in 1987):			
Properties	<b>—</b>	53,719	—
Long-term debt	<b>—</b>	(43,514)	—
Excess of cost over fair value of net assets acquired	<b>—</b>	35,049	—
Other, net noncurrent assets	<b>—</b>	17,091	—
Net noncurrent assets	<b>—</b>	62,345	—
	<b>382,639</b>	250,133	135,037
Increase (decrease) in working capital	<b>\$ 57,528</b>	\$ (37,800)	\$ 83,730
Working capital increased (decreased) by:			
Cash and marketable securities	<b>\$ (48,496)</b>	\$ (63,549)	\$ 83,609
Receivables	<b>39,902</b>	44,530	5,467
Inventories	<b>71,188</b>	86,791	(10,824)
Prepaid expenses and other current assets	<b>10,051</b>	3,067	(9,481)
Notes payable	<b>(1,677)</b>	(68,840)	—
Current maturities	<b>3,743</b>	(2,268)	11,242
Accounts payable and accrued expenses	<b>(30,108)</b>	(32,903)	9,182
Income taxes	<b>12,925</b>	(4,628)	(5,465)
	<b>\$ 57,528</b>	\$ (37,800)	\$ 83,730

See accompanying notes to consolidated financial statements.

## Consolidated Statement of Shareholders' Equity

(Dollars in thousands except per share data)

	Preferred Stock	Common Stock		Capital Surplus	Retained Earnings	Total
		Issued	Treasury			
<b>Balance February 28, 1985</b>						
As originally reported	\$73,304	\$117,102	\$ (80,157)	\$ 91,496	\$ 863,019	\$1,064,764
Pooled company		<u>44,200</u>		<u>944</u>	<u>102,197</u>	<u>147,341</u>
As restated	73,304	161,302	(80,157)	92,440	965,216	1,212,105
Net earnings					119,849	119,849
Cash dividends:						
Preferred stock					(5,405)	(5,405)
Common stock—\$1.54					(43,689)	(43,689)
By pooled company					(7,391)	(7,391)
Conversion of preferred stock:						
Series D—74,498 shares	(7,450)	1,208		6,241		(1)
Issuance of common stock:						
Options—262,793 shares		986		4,734		5,720
ESOP—21,102 shares			668	66		734
Restricted stock—71,727 shares		269		833		1,102
Purchase of 70,200 shares			(2,250)			(2,250)
Foreign currency translations					(685)	(685)
Other	173			(109)		64
<b>Balance February 28, 1986</b>	<b>66,027</b>	<b>163,765</b>	<b>(81,739)</b>	<b>104,205</b>	<b>1,027,895</b>	<b>1,280,153</b>
Net earnings					125,774	125,774
Cash dividends:						
Preferred stock					(4,972)	(4,972)
Common stock—\$1.57					(44,867)	(44,867)
By pooled company					(8,406)	(8,406)
Retirement of capital stock:						
Preferred—8,000 shares	(800)			(1,312)		(2,112)
Common—502,350 shares		(1,884)	15,354	(13,470)		—
Conversion of preferred stock:						
Series D—34,327 shares	(3,432)	556		2,874		(2)
Issuance of common stock:						
Options—193,610 shares		711	171	3,674		4,556
ESOP—20,126 shares			784	(6)		778
Restricted stock—132,045 shares		495		2,281		2,776
Purchase of 868,550 shares			(31,045)			(31,045)
Foreign currency translations					1,219	1,219
Conform pooled company					2,363	2,363
<b>Balance February 28, 1987</b>	<b>61,795</b>	<b>163,643</b>	<b>(96,475)</b>	<b>98,246</b>	<b>1,099,006</b>	<b>1,326,215</b>
Net earnings					145,003	145,003
Cash dividends:						
Preferred stock					(4,621)	(4,621)
Common stock—\$1.60					(57,983)	(57,983)
By pooled company					(1,615)	(1,615)
Retirement of capital stock:						
Preferred—27,605 shares	(2,761)			(3,505)		(6,266)
Common—2,457,728 shares		(9,216)	63,315	(54,099)		—
Conversion of preferred stock:						
Series D—19,208 shares	(1,921)	311		1,609		(1)
Issuance of common stock:						
Options—93,321 shares		350	48	2,288		2,686
Purchase of 4,166,582 shares			(152,255)			(152,255)
Foreign currency translations					174	174
<b>Balance February 29, 1988</b>	<b>\$57,113</b>	<b>\$155,088</b>	<b>\$ (185,367)</b>	<b>\$ 44,539</b>	<b>\$1,179,964</b>	<b>\$1,251,337</b>

See accompanying notes to consolidated financial statements.

## Notes to Consolidated Financial Statements

(Dollars in thousands except per share data)

### 1. Significant Accounting Policies

The company and its subsidiaries follow generally accepted accounting principles to present fairly their consolidated financial position, results of operations, and changes in financial position. The major accounting policies of the company are set forth below.

- **Principles of Consolidation**—The consolidated financial statements include the accounts of the company and all its subsidiaries, the majority of which are wholly owned. All material intercompany transactions have been eliminated in consolidation.
- **Fiscal Year**—The company's fiscal year ends on the last day of February.
- **Two-for-One Stock Split**—A two-for-one common stock split was effected July 23, 1986, and the number of shares and per share amounts included in the consolidated financial statements and notes thereto were restated to retroactively reflect the stock split.
- **Marketable Securities**—Marketable equity securities (common and preferred stocks) are stated at the lower of cost or market. Aggregate net unrealized losses are included in results of operations if related to current assets and in shareholders' equity if related to noncurrent assets. Other marketable securities are stated at cost, which approximates market value, unless there is an indication of permanent impairment of value, in which case the adjustment to market value is included in results of operations. The cost of marketable securities sold is determined on the specific identification method.
- **Inventories**—Inventories are stated at the lower of cost (first-in, first-out) or market, except for certain footwear manufacturing and general retail inventories which are valued on the "last-in, first-out" method of inventory valuation.
- **Property, Plant and Equipment**—Property, plant and equipment, including facilities and equipment leased under capital leases, are stated at cost. Expenditures for improvements are capitalized, while normal repairs and maintenance are expensed as incurred. When properties are retired or otherwise disposed of, the related cost and accumulated depreciation or amortization are removed from the accounts and gains or losses on the dispositions are reflected in results of operations. For financial reporting purposes, the company utilizes both accelerated and straight-line methods of computing depreciation and amortization. Such expense is computed based on the estimated useful lives of the respective assets or term of lease, if less, which generally range from 15 to 40 years for buildings and improvements, and from 3 to 20 years for machinery and equipment. Approximately 75% of depreciation and amortization expense was computed using the straight-line method in each fiscal year presented.
- **Excess of Cost Over Fair Value of Net Assets Acquired**—The excess of cost over fair value of net assets of companies acquired is included in other assets and is being amortized on a straight-line basis, over periods ranging from 25 to 40 years.

## **Notes to Consolidated Financial Statements (Cont'd)**

(Dollars in thousands except per share data)

■ **Income Taxes**—Deferred income taxes are provided on transactions which are reported for financial reporting purposes in different periods than for income tax purposes. For periods prior to fiscal 1987, investment tax credits are reflected as a reduction of Federal income taxes in the period in which qualified property is placed in service. It is the company's intent that the undistributed earnings of its subsidiaries will either be reinvested in the subsidiaries or distributed tax-free to the parent company. Generally, no provision has been made for income taxes on such undistributed earnings. The Financial Accounting Standards Board issued Financial Accounting Standard No. 96—Accounting for Income Taxes, in December 1987 effective for fiscal years beginning after December 15, 1988. The company has not determined the impact of this pronouncement; however, management is of the opinion that the adoption of these new accounting regulations will not have a material impact on the consolidated financial statements.

### **2. Business Combinations**

During fiscal 1988, the company acquired all the outstanding stock of The Lane Company, Inc. in exchange for 11,616,023 shares of the company's common stock. Prior to the exchange of shares, the company acquired 334,900 common shares of The Lane Company, Inc. in fiscal 1987 for cash of \$15,140. This transaction was accounted for as a pooling of interests; and, accordingly, the accounts of this company have been included in the accompanying consolidated financial statements for fiscal 1988, fiscal 1987 and fiscal 1986. Prior to restatement for this business combination, consolidated net sales and net earnings of the company for fiscal 1987 were \$2,613,739 and \$98,643, respectively, and for fiscal 1986 were \$2,510,740 and \$92,347, respectively. The Lane Company, Inc. reported net sales of \$333,163 and \$321,644, and net earnings of \$27,345 and \$27,502 for their fiscal years ended January 3, 1987 and December 28, 1985, respectively. Retained earnings, as of February 28, 1987, have been adjusted for the pooled company's operations for the months of January and February 1987. This acquisition is included in the Furniture and Home Furnishings Segment of the company.

On September 8, 1986, the company acquired all the outstanding stock of Converse Inc. The acquisition price of \$143,717, including capitalized expenses, was paid in cash. The transaction was accounted for as a purchase and accordingly, Converse's operations have been included in the consolidated financial statements and in the Footwear Manufacturing and Retailing Segment of the company from the date of acquisition. The total acquisition cost exceeded the fair value of the net assets acquired by \$28,781, and the excess has been allocated to goodwill. Also, in fiscal 1987, the company made three smaller acquisitions for cash payments totaling \$29,359.

### **3. Inventories**

Inventories are summarized as follows:

	<b>1988</b>	<b>1987</b>	<b>1986</b>
Retail merchandise	<b>\$243,991</b>	\$234,943	\$236,326
Finished products	<b>325,939</b>	286,151	220,485
Work in process	<b>74,922</b>	67,010	60,168
Raw materials	<b>160,243</b>	145,803	130,137
	<b>\$805,095</b>	<b>\$733,907</b>	<b>\$647,116</b>

All of the major categories of inventory include certain items valued on the "last-in, first-out" method. Had the "first-in, first-out" method been applied to all inventories, they would have been stated at approximately \$831,185, \$765,132 and \$678,973 at fiscal years 1988, 1987 and 1986, respectively.

**4. Lines of Credit**

The company has an eight-year domestic revolving credit agreement enabling it to borrow up to \$150,000 from several U.S. banks. Under the agreement there are various borrowing options based on domestic and Euro-Dollar interest rates. In addition, the company has a five-year credit agreement enabling it to borrow up to \$50,000 in Euro-Dollar loans from a group of foreign banks under various borrowing options based on Euro-Dollar interest rates.

The company also maintains other bank lines of credit which provide added credit availability and support for the sale of commercial paper. On February 29, 1988, the total unused lines of credit under these agreements were \$29,000.

Average short-term borrowings outstanding during fiscal 1988, 1987 and 1986 were \$123,000, \$57,000 and \$27,000, respectively, with a weighted average interest rate thereon of 7.1%, 6.1% and 7.8%, respectively. Maximum short-term borrowings at any month-end were \$172,500, \$141,500 and \$41,000 in fiscal years 1988, 1987 and 1986, respectively.

**5. Long-Term Debt**

Long-term debt consisted of the following:

	<b>1988</b>	<b>1987</b>	<b>1986</b>
7.95% to 8.875% promissory notes due 1991 to 1993	<b>\$200,000</b>	\$ —	\$ —
14.25% promissory notes	—	75,000	75,000
8.625% promissory installment note, payable \$1,000 annually through 1993, and balance in 1994	11,000	12,000	13,000
5% to 12% industrial revenue bonds payable in varying amounts through 2011	41,798	44,631	37,132
Other debt at 4.625% to 9% interest rates, payable in varying amounts through 2006	7,786	11,307	7,935
	<b>260,584</b>	<b>142,938</b>	<b>133,067</b>
Less current maturities	2,008	6,460	3,983
Less market adjustment	1,249	1,459	1,675
	<b>\$257,327</b>	<b>\$135,019</b>	<b>\$127,409</b>

During the fourth quarter of fiscal 1988, the company issued \$200,000 of intermediate term promissory notes with various interest rates and maturity dates. A January 15, 1988 promissory note in the amount of \$125,000 with an interest rate of 8.875% matures on January 15, 1993. Three promissory notes in the amount of \$25,000 each were issued on February 5, 1988, February 25, 1988 and February 16, 1988, with interest rates of 7.95%, 8.30% and 8.45%, and with maturity dates of February 5, 1991, February 25, 1992, and February 16, 1993, respectively. The \$125,000 promissory note was issued at a discount of \$938 and the discount and the costs relating to the issuance of the notes are being amortized over the respective lives of the notes as a charge to interest expense.

Maturities of long-term debt are \$2,008, \$6,489, \$36,610, \$26,458 and \$153,364 for fiscal years 1989 through 1993, respectively. The market adjustment relates to purchase adjustments of the long-term debt assumed in the acquisition of Ethan Allen, Inc.

The 14.25% promissory notes were redeemed on February 15, 1988, at the principal amount, without premium.

The company is in compliance with the covenants of its debt agreements and does not believe that the covenants will restrict its future operations.

## **Notes to Consolidated Financial Statements (Cont'd)**

(Dollars in thousands except per share data)

### **6. Obligations Under Capital Leases**

The amount capitalized under capital leases is the lesser of the present value of the minimum lease payments or the fair value of the leased properties at the beginning of the respective lease terms. Generally, interest rates applicable to capital leases range between 8.6% and 16.7% for leased facilities and between 5.5% and 10.7% for leased equipment. Obligations under capital leases amounted to \$47,977, \$56,001 and \$62,159 at fiscal years ended 1988, 1987 and 1986, respectively. Maturities of these obligations are \$6,164, \$5,770, \$5,590, \$4,862, and \$4,290 for fiscal years 1989 through 1993, respectively.

### **7. Preferred Stock**

The company's preferred stock is issuable in series. At fiscal years ended 1988, 1987 and 1986, the outstanding preferred stock consisted of 571,133, 617,946 and 660,273 shares, respectively, of Series D \$7.75 cumulative convertible with stated and involuntary liquidating value of \$100.00 per share.

Each share of the Series D preferred stock is convertible into 4.3242 shares of the company's common stock. Subject to the satisfaction of certain conditions relating to common stock dividends paid, the Series D preferred stock may be redeemed at the company's option at \$105.75 per share, decreasing to \$104.75 per share on January 29, 1989. On or after January 29, 1989, the Series D preferred stock may be redeemed at the company's option at \$104.75 per share, decreasing to \$100.00 per share in 1994.

### **8. Common Stock**

Shares of common stock were reserved for the following purposes at February 29, 1988:

	Number of Shares
Common stock options:	
Granted	776,325
Acquired company options assumed	73,987
Available for grant	419,176
Restricted stock plan of acquired company	461,601
Conversion of preferred stock	2,469,693
	<u>4,200,782</u>

Subsequent to February 29, 1988, the company issued 35,687 shares of common stock earned under the restricted stock plan during fiscal 1988.

Under the company's stock option plans, certain key employees may be granted incentive options, nonqualified options, stock appreciation rights, or combinations thereof. Nonqualified options and stock appreciation rights granted under the 1977 Plan may not be less than 85% of the fair market value (100% as to incentive options and related stock appreciation rights) of the common stock on the date of grant. Options and stock appreciation rights granted under the 1980 and 1985 Plans may not be less than 100% of the fair market value of the common stock on the date of grant. All options which have been granted, incentive or nonqualified, were at 100% of fair market value on the date of grant. Incentive options and nonqualified options expire ten years after the date of grant. At February 29, 1988, no appreciation rights have been granted.

At February 29, 1988, information regarding options granted but not exercised was as follows:

	Option Shares Outstanding	Dates of Grant	Price Range
1977 Plan	49,447	November 17, 1978 —October 7, 1985	\$17.50-\$42.60
1980 Plan	578,978	December 19, 1980 —July 30, 1987	\$20.1875-\$50.25
1982 Plan	72,637	August 25, 1983 —November 3, 1986	\$14.78-\$28.66
1985 Plan	147,900	March 10, 1987 —July 30, 1987	\$42.60-\$50.25

Changes in options granted are summarized as follows:

	1988		1987		1986	
	Shares	Average Price	Shares	Average Price	Shares	Average Price
Beginning of year	<b>637,120</b>	<b>\$27.17</b>	800,756	\$26.85	1,039,780	\$26.28
Assumed option of acquired companies	<b>103,488</b>	<b>24.02</b>	6,743	4.84	—	—
Granted	<b>284,250</b>	<b>42.94</b>	—	—	11,500	33.17
Exercised	<b>(93,321)</b>	<b>24.67</b>	(142,479)	24.21	(194,222)	24.10
Cancelled	<b>(81,225)</b>	<b>29.75</b>	(27,900)	27.82	(56,302)	27.18
End of year	<b>850,312</b>	<b>\$32.30</b>	<b>637,120</b>	<b>\$27.17</b>	<b>800,756</b>	<b>\$26.85</b>
Exercisable at end of year	<b>383,181</b>		<b>283,197</b>		<b>259,454</b>	

Under programs for purchasing the company's stock, 4,166,582 shares of common stock were repurchased during fiscal 1988 at a cost of \$152,255. Since substantially all the shares were purchased in the last half of the year, their acquisition did not have a material impact on the fiscal 1988 earnings per share. Beginning in fiscal 1988, common treasury shares are retired and restored to the status of authorized but unissued shares as new issue common shares are used for employee benefit plans and for the conversion of the company's preferred stock.

In fiscal 1986, the company declared a dividend of one Common Share Purchase Right for each then outstanding share of common stock. In addition, one right has been or will be issued with each share of common stock issued by the company after October 4, 1985, and before the date the rights become exercisable, are redeemed by the company, or expire on October 4, 1990. The rights will not be exercisable, or transferable apart from the common stock, until ten days after another person or group of persons acquires 20% or more of the common stock or commences, or announces its intention to commence, a tender or exchange offer for 30% or more of the common stock. Each right entitles its holder to buy one share of common stock at an exercise price of \$75.00. In certain circumstances, the rights will entitle their holders to purchase larger amounts of common stock or stock in an acquiring company. In addition to the shares reserved above, an additional 45,557,629 shares have been reserved under this plan.

**Notes to Consolidated  
Financial Statements (Cont'd)**  
(Dollars in thousands except per share data)

**9. Income Taxes**

Income tax expense was comprised of the following:

	<b>1988</b>	1987	1986
Current:			
Federal	<b>\$86,822</b>	\$ 89,416	\$ 76,724
State and local	<b>16,486</b>	13,846	12,410
Foreign	<b>1,777</b>	2,441	2,398
	<b>105,085</b>	105,703	91,532
Deferred	<b>3,372</b>	6,234	17,476
	<b>\$108,457</b>	<b>\$111,937</b>	<b>\$109,008</b>
ESOP, investment and jobs tax credits	<b>\$ 292</b>	\$ 1,082	\$ 4,575

The following table reconciles the differences between the Federal corporate statutory rate and the company's effective income tax rate:

	<b>1988</b>	1987	1986
Federal corporate statutory rate	<b>38.0%</b>	46.0%	46.0%
State and local income taxes, net of			
Federal tax benefit	<b>4.4</b>	3.1	3.1
ESOP, investment and jobs tax credits	<b>(0.1)</b>	(0.5)	(2.0)
Foreign taxes, including foreign			
currency translation effects	<b>0.3</b>	0.1	0.2
Other	<b>0.2</b>	(1.6)	0.3
Effective income tax rate	<b>42.8%</b>	<b>47.1%</b>	<b>47.6%</b>

Certain items are recognized for income tax purposes in years other than those in which they are reported in the consolidated financial statements. Future income tax benefits and deferred credits at the end of each fiscal year are included in the accompanying consolidated balance sheet, as follows:

	<b>1988</b>	1987	1986
Prepaid expenses and other current assets	<b>\$ 8,342</b>	\$ 6,138	\$ 8,566
Other long-term liabilities	<b>(38,348)</b>	(32,772)	(23,038)
	<b>\$(30,006)</b>	<b>\$(26,634)</b>	<b>\$(14,472)</b>

The Federal income tax returns of the company and its major subsidiaries have been examined through fiscal year ended February 29, 1984. The Federal income tax returns of the company and its major subsidiaries for the taxable years of 1985 and 1986 are currently in the process of examination. Management is of the opinion that the results of these examinations will have no material effect on the company's consolidated financial position or results of operations.

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**10. Employee Benefits**

The company and its subsidiaries sponsor or contribute to retirement plans covering substantially all employees. The total cost of all plans for fiscal 1988, fiscal 1987 and fiscal 1986 was \$16,600, \$18,600 and \$18,200, respectively.

**Company Sponsored Defined Benefit Plans:**

In fiscal 1988 the company adopted Financial Accounting Standards (FAS) Statement No. 87 - Employers' Accounting for Pensions, which superseded all previous standards of pension accounting. The decrease in pension cost in fiscal 1988 resulted principally from the adoption of FAS 87.

Annual cost for domestic defined benefit plans under FAS 87 is determined using the Projected Unit Credit actuarial method. Prior service cost is amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits.

It is the company's practice to fund pension costs to the extent that such costs are tax deductible. Funding decisions made in fiscal 1988 contributed towards the deferred or prepaid pension cost in U.S. plans. The assets of the various plans include corporate equities, government securities, corporate debt securities, income producing real estate, and insurance contracts.

The tables provide information on the status of the U.S. company sponsored, defined benefit plans.

The funded status at February 29, 1988 was as follows:

	Plans in which Assets Exceed Accumulated Benefits	Accumulated Benefits Exceed Assets
Actuarial present value of benefit obligations:		
Vested benefit obligation	<u>\$155,423</u>	<u>\$ 11,339</u>
Accumulated benefit obligation	<u>\$163,194</u>	<u>\$ 11,974</u>
Projected benefit obligation	<u>\$191,031</u>	<u>\$ 13,657</u>
Plan assets at fair value	<u>236,988</u>	<u>9,939</u>
Projected benefit obligation (in excess of) or less than plan assets	45,957	(3,718)
Unrecognized net (gain) or loss	(18,305)	(1,967)
Unrecognized prior service cost	—	—
Unrecognized net (asset) or obligation at February 29, 1988	<u>(26,820)</u>	<u>3,198</u>
(Accrued) or prepaid pension cost recognized in the statement of financial position	<u>\$ 832</u>	<u>\$ (2,487)</u>

Net periodic pension cost for the year ended February 29, 1988 include the following components:

	1988
Service cost—benefits earned during the period	\$ 8,642
Interest cost on the projected benefit obligation	17,815
Actual return on plan assets	7,507
Net amortization and deferral	(28,742)
Net periodic pension cost	<u>\$ 5,222</u>

## **Notes to Consolidated Financial Statements (Cont'd)**

(Dollars in thousands except per share data)

Employees are covered primarily by noncontributory plans, funded by company contributions to trust funds, which are held for the sole benefit of employees. Monthly retirement benefits generally are based upon service, pay or both, with employees generally becoming vested upon completion of 10 years of service.

The expected long-term rate of return on plan assets was 8.0% to 8.5% in fiscal 1988. Measurement of the fiscal 1988 projected benefit obligation was based on a 9.25% discount rate and a 5.5% long-term rate of compensation increase.

### **Other Retirement Plans and Benefits:**

In addition to defined benefit plans, the company makes contributions to various defined contribution, union negotiated, and foreign plans. The cost of these plans are included in the total cost for all plans reflected above.

The company has a Savings Plan for Employees of INTERCO INCORPORATED and Affiliates and an INTERCO INCORPORATED Employee Stock Ownership Plan (ESOP). The total cost of these plans for fiscal years 1988, 1987 and 1986 was \$751, \$638 and \$612, net of taxes of \$562, \$1,242 and \$1,307, respectively.

The company provides certain health care and life insurance benefits for certain employees who reach retirement age. Retiree health and life insurance benefits are provided through insurance companies. Post-retirement health care and life insurance expense for fiscal years 1988, 1987 and 1986 was \$1,362, \$1,407 and \$1,422, respectively.

### **11. Lease Commitments**

Substantially all of the company's retail outlets and certain other real properties and equipment are operated under lease agreements expiring at various dates through the year 2022. Leases covering retail outlets and equipment generally require, in addition to stated minimums, contingent rentals based on retail sales and equipment usage. Generally, the leases provide for renewal for various periods at stipulated rates.

Assets recorded under capital leases were as follows:

	<b>1988</b>	<b>1987</b>	<b>1986</b>
Land	\$ 849	\$ 783	\$ 783
Buildings	68,754	78,234	82,158
Machinery and equipment	13,228	9,029	9,360
	<hr/> <b>82,831</b>	<hr/> <b>88,046</b>	<hr/> <b>92,301</b>
Accumulated depreciation	44,982	44,053	43,636
	<hr/> <b>\$37,849</b>	<hr/> <b>\$43,993</b>	<hr/> <b>\$48,665</b>

Future minimum lease payments under capital leases, reduced by minimum rentals from subleases of \$3,607 at February 29, 1988, aggregate \$79,035 of which \$47,977 is included in obligations under capital leases and current maturities. \$23,396 represents interest, and the balance represents other costs of the leases including taxes, insurance and maintenance. Annual payments under capital leases are \$11,216, \$10,233, \$9,516, \$8,298 and \$7,307 for fiscal years 1989 through 1993, respectively.

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Total rent expense was as follows:

	<b>1988</b>	1987	1986
Basic rentals under operating leases	<b>\$39,078</b>	\$42,255	\$38,724
Contingent rentals, operating and capital leases	<b>38,717</b>	37,451	33,754
	<b>77,795</b>	79,706	72,478
Less sublease rentals	<b>1,213</b>	1,311	1,718
	<b>\$76,582</b>	<b>\$78,395</b>	<b>\$70,760</b>

Included in rent expense above is the cost of services provided by lessors of leased retail departments, estimated to aggregate \$17,800, \$18,500 and \$16,700 in fiscal years 1988, 1987 and 1986, respectively.

Future minimum lease payments under operating leases, reduced by minimum rentals from subleases of \$3,422, at February 29, 1988, aggregate \$184,977. Annual payments under operating leases are \$33,451, \$28,877, \$25,583, \$21,945 and \$17,534 for fiscal years 1989 through 1993, respectively.

## **12. Litigation**

The company is or may become a defendant in a number of pending or threatened legal proceedings in the ordinary course of business. In the opinion of management, the ultimate liability, if any, of the company from all such proceedings will not have a material effect upon the consolidated financial position.

## **13. Earnings Per Share**

Earnings per share are based on the weighted average number of shares of common stock and common stock equivalents outstanding during the year, plus those common shares which would have been issued if conversion of all preferred stock and convertible debentures had taken place at the beginning of each year or since date of issuance. Stock options, the exercise of which would result in dilution of earnings per share, are considered common stock equivalents. Net earnings for these computations are increased by the net interest expense on the convertible debentures in fiscal 1986. Primary earnings per share do not differ significantly from fully diluted earnings per share.

## Notes to Consolidated Financial Statements (Cont'd)

(Dollars in thousands except per share data)

### 14. Business Segment Information

The company's four business segments are Apparel Manufacturing, General Retail Merchandising, Footwear Manufacturing and Retailing, and Furniture and Home Furnishings. Specific information, on an unaudited basis, relating to the operating companies and their products, which comprise each segment, is included on the inside front cover and on pages 6 through 21. Summarized financial information by business segment is as follows:

	1988	1987	1986
Net sales to unaffiliated customers:			
Apparel	<b>\$ 813,198</b>	\$ 817,660	\$ 907,833
General Retail	<b>532,251</b>	498,324	461,785
Footwear	<b>890,411</b>	663,521	558,286
Furniture	<b>1,105,563</b>	967,397	904,480
Total	<b>\$3,341,423</b>	<b>\$2,946,902</b>	<b>\$2,832,384</b>
Operating earnings:			
Apparel	<b>\$ 20,240</b>	\$ 47,269	\$ 66,716
General Retail	<b>39,101</b>	40,610	32,085
Footwear	<b>92,204</b>	52,136	48,475
Furniture	<b>149,090</b>	123,766	105,111
	<b>300,635</b>	263,781	252,387
Corporate expenses and interest cost	<b>(47,175)</b>	<b>(26,070)</b>	<b>(23,530)</b>
Earnings before income taxes	<b>\$ 253,460</b>	<b>\$ 237,711</b>	<b>\$ 228,857</b>
Identifiable assets at year end:			
Apparel	<b>\$ 425,350</b>	\$ 465,601	\$ 456,972
General Retail	<b>252,195</b>	248,639	234,004
Footwear	<b>595,861</b>	497,706	291,292
Furniture	<b>688,853</b>	640,106	618,980
	<b>1,962,259</b>	1,852,052	1,601,248
Corporate assets	<b>23,327</b>	73,335	155,645
Total	<b>\$1,985,586</b>	<b>\$1,925,387</b>	<b>\$1,756,893</b>
Depreciation expense:			
Apparel	<b>\$ 12,521</b>	\$ 12,123	\$ 11,965
General Retail	<b>9,681</b>	9,079	8,294
Footwear	<b>13,107</b>	10,638	8,286
Furniture	<b>26,208</b>	21,675	20,971
Capital expenditures:			
Apparel	<b>\$ 9,220</b>	\$ 8,869	\$ 13,433
General Retail	<b>10,735</b>	8,167	6,169
Footwear	<b>9,236</b>	7,486	8,114
Furniture	<b>36,188</b>	24,720	27,278

In the third quarter of fiscal 1988, the company initiated a program to restructure portions of its women's sportswear operations and recognized a pretax charge to operations of \$11,600 to cover the costs of the restructuring program.

Sales between business segments, which account for less than 1% of the sales of any one business segment, are considered immaterial and are netted against the sales of the respective segment. Operating earnings of the business segment include its sales less all operating expenses. Minority interests in certain subsidiaries are immaterial and have been included in corporate expenses and interest cost. Substantially all of the company's sales are made to unaffiliated customers. No customer accounted for 10% or more of consolidated sales. Foreign operations are not material.

Identifiable assets are those assets used by each segment in its operations. Corporate assets consist primarily of cash and marketable securities. Realized gains (losses) on the sale of marketable securities netted against corporate expenses and interest cost amounted to \$(181), \$13 and \$4,345 for fiscal years 1988, 1987 and 1986, respectively.

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**15. Quarterly Financial Information (Unaudited)**

Following is a summary of unaudited quarterly information for each of the years in the three year period ended February 29, 1988.

	First	Second	Third	Fourth
Net Sales:				
1988	\$781,421	\$842,909	\$923,966	\$793,127
1987	659,660	699,289	837,183	750,770
1986	668,383	721,049	772,240	670,712
Gross Profit:				
1988	\$252,479	\$266,032	\$281,731	\$256,541
1987	208,068	224,772	264,447	249,192
1986	204,922	227,745	235,714	231,745
Net Earnings:				
1988	\$ 26,514	\$ 38,429	\$ 43,449	\$36,611
1987	20,504	29,258	35,641	40,371
1986	17,305	30,011	33,215	39,318
Earnings Per Share:				
1988	\$0.62	\$0.90	\$1.05	\$0.93
1987	0.47	0.68	0.82	0.94
1986	0.40	0.69	0.76	0.90
Common Dividends Paid Per Share:				
1988	\$0.400	\$0.400	\$0.400	\$0.400
1987	0.385	0.385	0.400	0.400
1986	0.385	0.385	0.385	0.385
Common Stock Price Range (High-Low):				
1988	\$46-38	\$54-40	\$53-30	\$42-30
1987	45-37	48-39	47-38	45-37
1986	35-31	36-32	37-31	40-34

The closing market price of INTERCO's common and preferred stock at fiscal year end 1988 was \$42.00 and \$176.00 per share, respectively.

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**Independent Accountants' Report**

The Board of Directors and Shareholders  
INTERCO INCORPORATED:

We have examined the consolidated balance sheets of INTERCO INCORPORATED and subsidiaries as of February 29, 1988, February 28, 1987, and February 28, 1986, and the related consolidated statements of earnings, shareholders' equity, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of INTERCO INCORPORATED and subsidiaries at February 29, 1988, February 28, 1987, and February 28, 1986, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

*Peat Marwick Main & Co.*

St. Louis, Missouri  
April 11, 1988

## **Five Year Consolidated Financial Review**

(Dollars in thousands except per share data)

<b>Years Ended</b>	<b>1988</b>	<b>1987</b>	<b>1986</b>	<b>1985</b>	<b>1984</b>
<b>For The Year</b>					
Summary of operations:					
Net sales	<b>\$3,341,423</b>	\$2,946,902	\$2,832,384	\$2,910,679	\$2,905,928
Cost of sales	<b>2,284,640</b>	2,000,423	1,932,258	1,997,268	1,966,683
Interest expense	<b>33,535</b>	28,082	25,523	26,400	31,662
Earnings before income taxes	<b>253,460</b>	237,711	228,857	186,334	254,137
As a percent of sales	<b>7.6%</b>	8.1%	8.1%	6.4%	8.7%
Income taxes	<b>108,457</b>	111,937	109,008	90,841	119,827
Net earnings	<b>145,003</b>	125,774	119,849	95,493	134,310
As a percent of sales	<b>4.3%</b>	4.3%	4.2%	3.3%	4.6%
Net earnings applicable to common stock	<b>145,003</b>	125,774	119,853	95,502	134,320
Per share of common stock:					
Earnings	<b>\$3.50</b>	\$2.91	\$2.75	\$2.16	\$3.00
Dividends	<b>\$1.60</b>	\$1.57	\$1.54	\$1.515	\$1.44
Average common and common equivalent shares outstanding (in thousands)	<b>41,456</b>	43,312	43,608	44,285	44,698
Cash dividends paid:					
On common stock	<b>\$ 59,598</b>	\$ 53,273	\$ 51,080	\$ 50,390	\$ 46,704
On preferred stock	<b>\$ 4,621</b>	\$ 4,972	\$ 5,405	\$ 5,985	\$ 6,701
<b>At Year End</b>					
Working capital	<b>\$ 985,956</b>	\$ 928,428	\$ 966,228	\$ 882,499	\$ 937,808
Property, plant and equipment, net	<b>479,499</b>	485,350	441,820	444,219	449,217
Capital expenditures:					
Company owned property	<b>60,207</b>	49,378	54,404	64,050	55,576
Capitalized leased property	<b>5,673</b>	735	1,409	2,337	3,431
Total assets	<b>1,985,586</b>	1,925,387	1,756,893	1,702,415	1,753,623
Long-term debt	<b>257,327</b>	135,019	127,409	133,311	139,914
Obligations under capital leases	<b>41,813</b>	50,546	56,495	61,403	69,002
Shareholders' equity	<b>1,251,337</b>	1,326,215	1,280,153	1,212,105	1,229,442
Book value per common share	<b>\$ 33.01</b>	\$ 31.47	\$ 29.94	\$ 28.51	\$ 27.87

## Major Brand and Trade Names by Operating Group

Apparel	General Retail	Footwear	Furniture
<b>BRANDS</b>	<b>RETAIL TRADING NAMES</b>	<b>BRANDS</b>	<b>BRANDS</b>
<b>FOR MEN:</b>	<b>FOR WOMEN:</b>	<b>FOR MEN:</b>	<b>FOR MEN:</b>
Big Yank Campus Chuck's Clipper Mist Converse Cowden Cowden Genes Donegal Ed McMahon Fog J. A. International J J Cochran John Alexander Le Tigre' lil' Hunk London Fog London Towne Maincoats Outdoors Unlimited Prince Bellini Private Line Sergio Valente Sportabouts Startown Tailor's Bench Tempo Europa Tour de France Towne Limits Winning Edge Yanks	Abe Schrader Blake Chuck's City Linens College-Town Converse Cowden Cowden Genes CT Sport Devon G. B. Scott It's Pure Gould John Alexander Lady Devon London Fog London Towne Mallory & Crew Maincoats Ms. Blake Olivia Outdoors Unlimited Pant-her The Petite Concept Queen Casuals REJOICE Schrader Knits Schrader Sport Dresses Schrader Sport Separates Smith & Jones Smith & Jones For Her Smith & Jones Petites Stuffed Shirt Tour de France Towne Limits Two Rivers Vivaldi Winning Edge	Central Hardware Fine's Golde's Jeans Galore Sky City Discount Center United Shirt	Ambassador America's Tradesman Apple Christian Dior Chuck Taylor Conasaur Collection Cons Converse Converse All Star Converse Conveyor Évolو Fast Break Florsheim Comfortech by Florsheim Designer Collection Florsheim Idlers by Florsheim Florsheim Imperial Florsheim Royal Imperial Footrests GSV Hamptons Hy-Test Jack Purcell Julius Marlow Neehi Outdoorsman Pro Action Riva by Florsheim Sea Tracs by Florsheim Small Star Weeds Winthrop Worthmore X-Statics
<b>RETAIL TRADING NAMES</b>		<b>FOR WOMEN:</b>	<b>RETAIL TRADING NAMES</b>
		Accent Akimbo Avenues Converse Converse All Star Converse Conveyor Eclaire Évolо Fast Break Florsheim Florsheim Ramblers Florsheim Signature GSV Hamptons Marshmallows Suite 200 Thayer McNeil Velvet Step X-Statics	Broyhill Showcase Gallery Carriage House Ethan Allen Gallery Georgetown Manor Lane Gallery Manor House
		<b>RETAIL TRADING NAMES</b>	
		Florsheim Shoe Shops Florsheim Thayer McNeil Thompson, Boland & Lee Express Shop	

## Board of Directors

### Nathan S. Ancell

Chairman of the Board of  
Ethan Allen Inc.

### Ronald L. Aylward 1, 5

Vice Chairman of the Board  
of the Company

### Zane E. Barnes 2, 3, 4, 5

Chairman of the Board,  
President and Chief Executive Officer of  
Southwestern Bell Corporation

### William E. Cornelius

President and Chief Executive Officer of  
Union Electric Company

### Harry M. Krogh 1

President and Chief Operating Officer  
of the Company

### Donald E. Lasater 1, 2, 3, 4, 5

Chairman of the Board and  
Chief Executive Officer of Mercantile  
Bancorporation Inc., and Chairman of  
the Board of Mercantile Bank National  
Association

### Marilyn S. Lewis 2

Civic leader and volunteer

### Lee M. Liberman 2, 3, 4

Chairman of the Board, President and  
Chief Executive Officer of Laclede Gas  
Company

### Mark H. Lieberman

President of Londontown

### Richard B. Loynd

Chairman of the Board of Converse Inc.

### R. Stuart Moore

President of The Lane Company,  
Incorporated.

### Thomas H. O'Leary 2, 3, 4, 5

Vice Chairman of the Board of  
Burlington Northern Inc.

### Robert H. Quenon 4

President and Chief Executive Officer  
of Peabody Holding Co., Inc.

### Charles J. Rothschild, Jr.

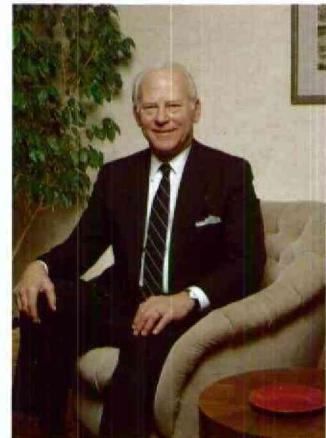
Chairman of the Board of  
Megastar Apparel Group

### Harvey Saligman 1, 5

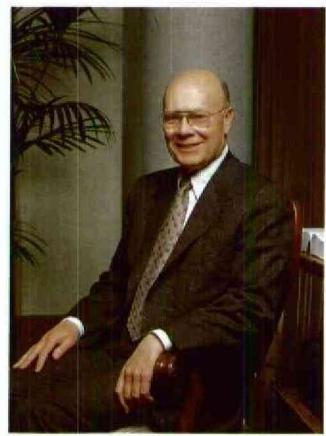
Chairman of the Board and Chief  
Executive Officer of the Company



Nathan S. Ancell



William E. Cornelius



Harry M. Krogh



Ronald L. Aylward



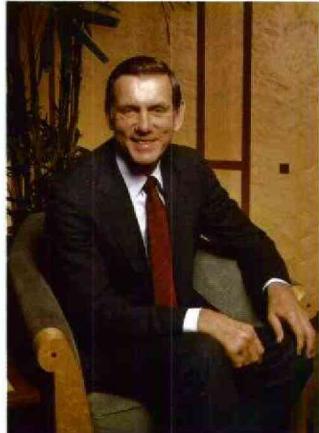
Donald E. Lasater



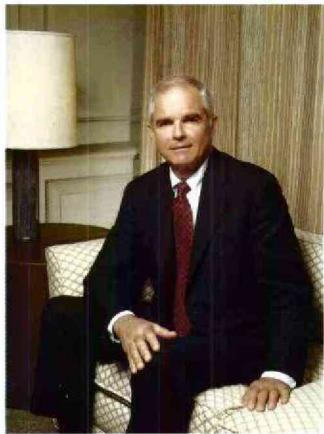
Zane E. Barnes



Marilyn S. Lewis

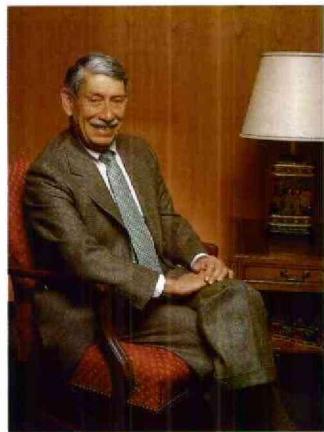


Richard B. Loynd



Robert H. Quenon

- 1 Executive Committee
- 2 Audit Committee
- 3 Executive Compensation and Stock Option Committee
- 4 Finance Committee
- 5 Nominating Committee



Lee M. Liberman



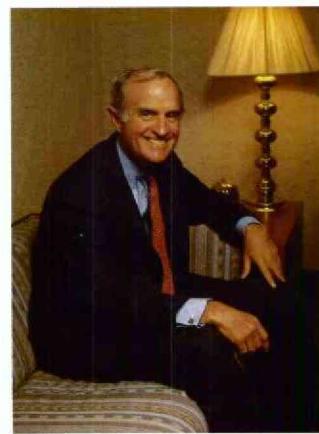
R. Stuart Moore



Charles J. Rothschild, Jr.



Mark H. Lieberman



Thomas H. O'Leary



Harvey Saligman

## **Corporate Officers**

**Harvey Saligman**  
Chairman of the Board and  
Chief Executive Officer

**Ronald L. Aylward**  
Vice Chairman of the Board

**Harry M. Krogh**  
President and Chief Operating  
Officer

**Eugene F. Smith**  
Senior Vice President, Finance

**Charles J. Rothschild, Jr.**  
Vice President

**Nathan S. Ancell**  
Vice President

**Mark H. Lieberman**  
Vice President

**R. Stuart Moore**  
Vice President

**Richard B. Loynd**  
Vice President

**Ronald J. Mueller**  
Vice President

**Duane A. Patterson**  
Secretary

**Robert T. Hensley, Jr.**  
Treasurer

**Stanley F. Huck**  
Controller

**Keith E. Mattern**  
General Counsel and  
Assistant Secretary

**James K. Pendleton**  
Assistant Secretary

**William R. Withrow**  
Assistant Treasurer

**Russell L. Baumann**  
Assistant Controller

## **Operating Board**

**Harvey Saligman**  
Chairman of the Board and  
Chief Executive Officer of the  
Company

**Ronald L. Aylward**  
Vice Chairman of the Board  
of the Company

**Harry M. Krogh**  
President and Chief Operating  
Officer of the Company

**Eugene F. Smith**  
Senior Vice President, Finance  
of the Company

**Nathan S. Ancell**  
Chairman of the Board,  
Ethan Allen, Inc.

**Edwin J. Baum**  
President,  
The Biltwell Company, Inc.

**Lionel Baxter**  
Chairman of the Board,  
Big Yank Corporation

**James H. Cohen**  
President,  
Central Hardware Company

**Barry S. Fine**  
Chairman of the Board,  
Fine's Men's Shops,  
Incorporated

**Carl E. Gunter**  
President,  
Broyhill Furniture  
Industries, Inc.

**Mark H. Lieberman**  
President, Londontown

**Richard B. Loynd**  
Chairman of the Board,  
Converse Inc.

**Stanley Matzkin**  
Chairman of the Board,  
Devon Apparel

**R. Stuart Moore**  
President,  
The Lane Company,  
Incorporated

**Ronald J. Mueller**  
President,  
The Florsheim Shoe  
Company

**Don B. Olesen**  
President,  
International Hat  
Company

**Robert B. Peterson**  
Chairman of the Board,  
Sky City Stores, Inc.

**Charles J. Rothschild, Jr.**  
President,  
Megastar Apparel Group

**Morton J. Schrader**  
President,  
Abe Schrader Corporation

**Irving S. Wahl**  
Chairman of the Board,  
Stuffed Shirt Inc.

## **Principal Companies of INTERCO**

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### **Apparel Manufacturing Group**

**Abe Schrader Corporation**  
New York, New York

**Big Yank Corporation**  
New York, New York

**The Biltwell Company, Inc.**  
St. Louis, Missouri

**Megastar Apparel Group**  
Paramus, New Jersey

**College-Town**  
Braintree, Massachusetts

**Cowden Manufacturing Company**  
Lexington, Kentucky

**Devon Apparel**  
Philadelphia, Pennsylvania

**International Hat Company**  
St. Louis, Missouri

**Londontown**  
Eldersburg, Maryland

**Queen Casuals, Inc.**  
Philadelphia, Pennsylvania

**Stuffed Shirt Inc.**  
New York, New York

### **General Retail Merchandising Group**

**Central Hardware Company**  
St. Louis, Missouri

**Fine's Men's Shops, Incorporated**  
Norfolk, Virginia

**Golde's Department Stores, Inc.**  
St. Louis, Missouri

**Sky City Stores, Inc.**  
Asheville, North Carolina

**United Shirt Distributors, Inc.**  
Detroit, Michigan

### **Footwear Manufacturing and Retailing Group**

**Converse, Inc.**  
North Reading, Massachusetts

**The Florsheim Shoe Company**  
Chicago, Illinois

**International Shoe Company**  
St. Louis, Missouri

**Senack Shoes, Inc.**  
St. Louis, Missouri

### **Furniture and Home Furnishings Group**

**Broyhill Furniture Industries, Inc.**  
Lenoir, North Carolina

**Ethan Allen Inc.**  
Danbury, Connecticut

**The Lane Company, Incorporated**  
Altavista, Virginia

## **Shareholder Information**

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### **Transfer Agents**

(Common and Preferred Stock)  
Mercantile Bank, National Association  
St. Louis, Missouri 63166  
(314) 425-2755

Morgan Shareholder Services  
Trust Company  
New York, New York 10249  
(212) 587-6434

### **Registrars**

(Common and Preferred Stock)  
Centerre Trust Company  
St. Louis, Missouri 63178  
(314) 231-9300

Morgan Shareholder Services  
Trust Company  
New York, New York 10249  
(212) 587-6434

### **Dividend Disbursing Agent**

(Common and Preferred Stock)  
Mercantile Bank, National Association  
St. Louis, Missouri 63166  
(314) 425-2755

### **Independent Accountants**

Pearl Marwick Main & Co.  
1010 Market Street  
St. Louis, Missouri 63101  
(314) 444-1400

### **Exchange Listings**

Common and Preferred Shares are  
listed on the New York Stock  
Exchange. Common Shares are also  
listed on the Midwest Stock Exchange.  
(Trading symbol: ISS)

### **Corporate Offices**

101 South Hanley Road  
St. Louis, Missouri 63105  
(314) 863-1100

### **Annual Meeting**

The Annual Meeting of Shareholders will be  
held at 10 a.m., Monday, June 27, 1988, at  
the Clayton Community Center, Two Mark  
Twain Circle, Clayton, Missouri. Notice of the  
meeting and a proxy statement will be sent to  
shareholders in a separate mailing.

### **Trademarks and Trade Names**

The trademarks, trade names and licensed  
trademarks of INTERCO and its subsidiaries  
appearing in this Annual Report, are italicized.

### **Form 10-K Annual Report**

A copy of the current Form 10-K filed with  
the Securities and Exchange Commission  
can be obtained by writing to the Treasurer  
of INTERCO at the Corporate Offices.

**INTERCO INCORPORATED**

St. Louis, Missouri